

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1986

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter A—Determination of Tax Liability

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PART I—TAX ON INDIVIDUALS

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SEC. 1. TAX IMPOSED.

(a) * * *

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(h) **MAXIMUM CAPITAL GAINS RATE.—**

(1) * * *

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(11) **DIVIDENDS TAXED AS NET CAPITAL GAIN.—**

(A) * * *

* * * * *

(C) **QUALIFIED FOREIGN CORPORATIONS.—**

(i) * * *

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(iii) **EXCLUSION OF DIVIDENDS OF CERTAIN FOREIGN CORPORATIONS.—**Such term shall not include any foreign corporation which for the taxable year of the corporation in which the dividend was paid, or the preceding taxable year, is **[a foreign personal holding company (as defined in section 552), a foreign investment company (as defined in section 1246(b)), or]** a passive foreign investment company (as defined in section 1297).

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PART II—TAX ON CORPORATIONS

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SEC. 11. TAX IMPOSED.

(a) * * *

(b) AMOUNT OF TAX.—

[(1) IN GENERAL.—The amount of the tax imposed by subsection (a) shall be the sum of—

[(A) 15 percent of so much of the taxable income as does not exceed \$50,000,

[(B) 25 percent of so much of the taxable income as exceeds \$50,000 but does not exceed \$75,000,

[(C) 34 percent of so much of the taxable income as exceeds \$75,000 but does not exceed \$10,000,000, and

[(D) 35 percent of so much of the taxable income as exceeds \$10,000,000.

In the case of a corporation which has taxable income in excess of \$100,000 for any taxable year, the amount of tax determined under the preceding sentence for such taxable year shall be increased by the lesser of (i) 5 percent of such excess, or (ii) \$11,750. In the case of a corporation which has taxable income in excess of \$15,000,000, the amount of the tax determined under the foregoing provisions of this paragraph shall be increased by an additional amount equal to the lesser of (i) 3 percent of such excess, or (ii) \$100,000.]

(1) *FOR TAXABLE YEARS BEGINNING AFTER 2011.*—*In the case of taxable years beginning after 2011, the amount of the tax imposed by subsection (a) shall be determined in accordance with the following table:*

<i>If taxable income is:</i>	<i>The tax is:</i>
<i>Not over \$50,000</i>	<i>15% of taxable income.</i>
<i>Over \$50,000 but not over \$75,000</i>	<i>\$7,500, plus 25% of the excess over \$50,000.</i>
<i>Over \$75,000 but not over \$20,000,000</i>	<i>\$13,750, plus 32% of the excess over \$75,000.</i>
<i>Over \$20,000,000</i>	<i>\$6,389,750, plus 35% of the excess over \$20,000,000.</i>

(2) *FOR TAXABLE YEARS BEGINNING IN 2009, 2010, OR 2011.*—*In the case of taxable years beginning in 2009, 2010, or 2011, the amount of the tax imposed by subsection (a) shall be determined in accordance with the following table:*

<i>If taxable income is:</i>	<i>The tax is:</i>
<i>Not over \$50,000</i>	<i>15% of taxable income.</i>
<i>Over \$50,000 but not over \$75,000</i>	<i>\$7,500, plus 25% of the excess over \$50,000.</i>
<i>Over \$75,000 but not over \$5,000,000</i>	<i>\$13,750, plus 32% of the excess over \$75,000.</i>
<i>Over \$5,000,000 but not over \$10,000,000</i>	<i>\$1,589,750, plus 34% of the excess over \$5,000,000.</i>
<i>Over \$10,000,000</i>	<i>\$3,289,750, plus 35% of the excess over \$10,000,000.</i>

(3) *FOR TAXABLE YEARS BEGINNING IN 2007 OR 2008.*—*In the case of taxable years beginning in 2007 or 2008, the amount of the tax imposed by subsection (a) shall be determined in accordance with the following table:*

<i>If taxable income is:</i>	<i>The tax is:</i>
<i>Not over \$50,000</i>	<i>15% of taxable income.</i>

If taxable income is:	The tax is:
Over \$50,000 but not over \$75,000	\$7,500, plus 25% of the excess over \$50,000.
Over \$75,000 but not over \$1,000,000	\$13,750, plus 32% of the excess over \$75,000.
Over \$1,000,000 but not over \$10,000,000	\$309,750, plus 34% of the excess over \$1,000,000.
Over \$10,000,000	\$3,369,750, plus 35% of the excess over \$10,000,000.

(4) **FOR TAXABLE YEARS BEGINNING IN 2004, 2005, OR 2006.**—In the case of taxable years beginning in 2004, 2005, or 2006, the amount of the tax imposed by subsection (a) shall be determined in accordance with the following table:

If taxable income is:	The tax is:
Not over \$50,000	15% of taxable income.
Over \$50,000 but not over \$75,000	\$7,500, plus 25% of the excess over \$50,000.
Over \$75,000 but not over \$1,000,000	\$13,750, plus 33% of the excess over \$75,000.
Over \$1,000,000 but not over \$10,000,000	\$319,000, plus 34% of the excess over \$1,000,000.
Over \$10,000,000	\$3,379,000, plus 35% of the excess over \$10,000,000.

(5) **PHASEOUT OF LOWER RATES FOR CERTAIN TAXPAYERS.**—

(A) **GENERAL RULE FOR YEARS BEFORE 2012.**—

(i) **IN GENERAL.**—In the case of taxable years beginning before 2012 with respect to a corporation which has taxable income in excess of the applicable amount for any taxable year, the amount of tax determined under paragraph (1), (2), (3) or (4) for such taxable year shall be increased by the lesser of (I) 5 percent of such excess, or (II) the maximum increase amount.

(ii) **MAXIMUM INCREASE AMOUNT.**—For purposes of clause (i)—

In the case of any taxable year	beginning during:	The applicable amount is:	The maximum increase amount is:
2004, 2005, or 2006		\$1,000,000	\$21,000
2007 or 2008		\$1,000,000	\$30,250
2009, 2010, or 2011		\$5,000,000	\$110,250.

(B) **HIGHER INCOME CORPORATIONS.**—In the case of a corporation which has taxable income in excess of \$20,000,000 (\$15,000,000 in the case of taxable years beginning before 2012), the amount of the tax determined under the foregoing provisions of this subsection shall be increased by an additional amount equal to the lesser of (i) 3 percent of such excess, or (ii) \$610,250 (\$100,000 in the case of taxable years beginning before 2012).

[(2)] (6) **CERTAIN PERSONAL SERVICE CORPORATIONS NOT ELIGIBLE FOR GRADUATED RATES.**—Notwithstanding paragraph (1), the amount of the tax imposed by subsection (a) on the taxable income of a qualified personal service corporation (as defined in section 448(d)(2)) shall be equal to 35 percent of the taxable income.

(c) **LIMITATION ON TAX ON QUALIFIED PRODUCTION ACTIVITIES INCOME.**—

(1) *IN GENERAL.*—If a corporation has qualified production activities income for any taxable year, the tax imposed by this section shall not exceed the sum of—

(A) a tax computed at the rates and in the manner as if this subsection had not been enacted on the taxable income reduced by the amount of qualified production activities income, plus

(B) a tax equal to 32 percent (34 percent in the case of taxable years beginning before January 1, 2007) of the qualified production activities income (or, if less, taxable income).

(2) *QUALIFIED PRODUCTION ACTIVITIES INCOME.*—

(A) *IN GENERAL.*—The term “qualified production activities income” for any taxable year means an amount equal to the excess (if any) of—

(i) the taxpayer’s domestic production gross receipts for such taxable year, over

(ii) the sum of—

(I) the cost of goods sold that are allocable to such receipts,

(II) other deductions, expenses, or losses directly allocable to such receipts, and

(III) a ratable portion of other deductions, expenses, and losses that are not directly allocable to such receipts or another class of income.

(B) *ALLOCATION METHOD.*—The Secretary shall prescribe rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining income attributable to domestic production activities.

(3) *DOMESTIC PRODUCTION GROSS RECEIPTS.*—For purposes of this subsection, the term “domestic production gross receipts” means the gross receipts of the taxpayer which are derived from—

(A) any lease, rental, license, sale, exchange, or other disposition of—

(i) qualifying production property which was manufactured, produced, grown, or extracted in whole or in significant part by the taxpayer within the United States, or

(ii) any qualified film produced by the taxpayer, or

(B) construction, engineering, or architectural services performed in the United States for construction projects in the United States.

(4) *QUALIFYING PRODUCTION PROPERTY.*—For purposes of this subsection, the term “qualifying production property” means—

(A) tangible personal property,

(B) any computer software, and

(C) any property described in section 168(f)(4).

(5) *QUALIFIED FILM.*—For purposes of this subsection—

(A) *IN GENERAL.*—The term “qualified film” means any property described in section 168(f)(3) if not less than 50 percent of the total compensation relating to the production of such property is compensation for services performed in

the United States by actors, production personnel, directors, and producers.

(B) EXCEPTION.—Such term does not include property with respect to which records are required to be maintained under section 2257 of title 18, United States Code.

(6) RELATED PERSONS.—For purposes of this subsection—

(A) IN GENERAL.—The term “domestic production gross receipts” shall not include any gross receipts of the taxpayer derived from property leased, licensed, or rented by the taxpayer for use by any related person.

(B) RELATED PERSON.—For purposes of subparagraph (A), a person shall be treated as related to another person if such persons are treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414, except that determinations under subsections (a) and (b) of section 52 shall be made without regard to section 1563(b).

[(c)] *(d) EXCEPTIONS.—Subsection (a) shall not apply to a corporation subject to a tax imposed by—*

*(1) * * **

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[(d)] *(e) FOREIGN CORPORATIONS.—In the case of a foreign corporation, the taxes imposed by subsection (a) and section 55 shall apply only as provided by section 882.*

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PART IV—CREDITS AGAINST TAX

** * * * **

Subpart D—Business Related Credits

** * * * **

SEC. 38. GENERAL BUSINESS CREDIT.

*(a) * * **

(b) CURRENT YEAR BUSINESS CREDIT.—For purposes of this subpart, the amount of the current year business credit is the sum of the following credits determined for the taxable year:

*(1) * * **

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(14) in the case of an eligible employer (as defined in section 45E(c)), the small employer pension plan startup cost credit determined under section 45E(a), [plus]

(15) the employer-provided child care credit determined under section 45F(a)[.], plus

(16) in the case of an eligible wholesaler (as defined in section 5011(b)), the distilled spirits wholesaler credit determined under section 5011(a).

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SEC. 39. CARRYBACK AND CARRYFORWARD OF UNUSED CREDITS.

*(a) * * **

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(d) TRANSITIONAL RULES.—

(1) * * *

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(11) *NO CARRYBACK OF SECTION 5011 CREDIT BEFORE JANUARY 1, 2004.*—No portion of the unused business credit for any taxable year which is attributable to the credit determined under section 5011(a) may be carried back to a taxable year beginning before January 1, 2004.

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SEC. 45C. CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS FOR RARE DISEASES OR CONDITIONS.

(a) * * *

(b) **QUALIFIED CLINICAL TESTING EXPENSES.**—For purposes of this section—

(1) * * *

(2) **CLINICAL TESTING.**—

(A) * * *

* * * * *

(C) *TREATMENT OF CERTAIN EXPENSES INCURRED BEFORE DESIGNATION.*—For purposes of subparagraph (A)(ii)(I), if a drug is designated under section 526 of the Federal Food, Drug, and Cosmetic Act not later than the due date (including extensions) for filing the return of tax under this subtitle for the taxable year in which the application for such designation of such drug was filed, such drug shall be treated as having been designated on the date that such application was filed.

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Subpart G—Credit Against Regular Tax for Prior Year Minimum Tax Liability

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SEC. 53. CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.

(a) * * *

* * * * *

(d) **DEFINITIONS.**—For purposes of this section—(1) **NET MINIMUM TAX.**—

(A) * * *

(B) **CREDIT NOT ALLOWED FOR EXCLUSION PREFERENCES.**—(i) **ADJUSTED NET MINIMUM TAX.**—The adjusted net minimum tax for any taxable year is—

(I) * * *

(II) the amount which would be the net minimum tax for such taxable year if the only adjustments and items of tax preference taken into account were those specified in clause (ii) [and if section 59(a)(2) did not apply].

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PART VI—MINIMUM TAX FOR TAX PREFERENCES

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SEC. 55. ALTERNATIVE MINIMUM TAX IMPOSED.

(a) * * *

* * * * *

(c) REGULAR TAX.—

(1) * * *

(2) *COORDINATION WITH INCOME AVERAGING FOR FARMERS.*—Solely for purposes of this section, section 1301 (relating to averaging of farm income) shall not apply in computing the regular tax liability.

[(2)] (3) CROSS REFERENCES.—

For provisions providing that certain credits are not allowable against the tax imposed by this section, see sections 26(a), 29(b)(6), 30(b)(3) and 38(c).

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(e) EXEMPTION FOR SMALL CORPORATIONS.—

(1) IN GENERAL.—

(A) **[\$7,500,000] \$20,000,000** GROSS RECEIPTS TEST.—

The tentative minimum tax of a corporation shall be zero for any taxable year if the corporation's average annual gross receipts for all 3-taxable-year periods ending before such taxable year does not exceed **[\$7,500,000] \$20,000,000**. For purposes of the preceding sentence, only taxable years beginning after December 31, 1993, shall be taken into account.

(B) **\$5,000,000** GROSS RECEIPTS TEST FOR FIRST 3-YEAR PERIOD.—Subparagraph (A) shall be applied by substituting “\$5,000,000” for “**[\$7,500,000] \$20,000,000**” for the first 3-taxable-year period (or portion thereof) of the corporation which is taken into account under subparagraph (A).

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SEC. 56. ADJUSTMENTS IN COMPUTING ALTERNATIVE MINIMUM TAXABLE INCOME.

(a) * * *

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(d) ALTERNATIVE TAX NET OPERATING LOSS DEDUCTION DEFINED.—

(1) IN GENERAL.—For purposes of subsection (a)(4), the term “alternative tax net operating loss deduction” means the net operating loss deduction allowable for the taxable year under section 172, except that—

[(A)] the amount of such deduction shall not exceed the sum of—

[(i)] the lesser of—

[(I)] the amount of such deduction attributable to net operating losses (other than the deduction attributable to carryovers described in clause (ii)(I)), or

[(II) 90 percent of alternative minimum taxable income determined without regard to such deduction, plus

[(ii) the lesser of—

[(I) the amount of such deduction attributable to the sum of carrybacks of net operating losses for taxable years ending during 2001 or 2002 and carryforwards of net operating losses to taxable years ending during 2001 and 2002, or

[(II) alternative minimum taxable income determined without regard to such deduction reduced by the amount determined under clause (i), and]

(A) the amount of such deduction shall not exceed the applicable percentage (determined under paragraph (3)) of the alternative minimum taxable income determined without regard to such deduction, and

* * * * *

(3) **APPLICABLE PERCENTAGE.**—For purposes of paragraph (1)(A)—

<i>For taxable years beginning in calendar year—</i>	<i>The applicable percentage is—</i>
2005, 2006, or 2007	92
2008 or 2009	94
2010	96
2011	98
2012 or thereafter	100.

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(g) **ADJUSTMENTS BASED ON ADJUSTED CURRENT EARNINGS.**—

(1) * * *

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(6) **EXCEPTION FOR CERTAIN CORPORATIONS.**—This subsection shall not apply to any S corporation, regulated investment company, real estate investment trust, [REMIC, or FASIT] or REMIC.

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SEC. 59. OTHER DEFINITIONS AND SPECIAL RULES.

(a) **ALTERNATIVE MINIMUM TAX FOREIGN TAX CREDIT.**—For purposes of this part—

(1) * * *

[(2) **LIMITATION TO 90 PERCENT OF TAX.**—

[(A) **IN GENERAL.**—The alternative minimum tax foreign tax credit for any taxable year shall not exceed the excess (if any) of—

[(i) the pre-credit tentative minimum tax for the taxable year, over

[(ii) 10 percent of the amount which would be the pre-credit tentative minimum tax without regard to the alternative tax net operating loss deduction and section 57(a)(2)(E).

[(B) **CARRYBACK AND CARRYFORWARD.**—If the alternative minimum tax foreign tax credit exceeds the amount

determined under subparagraph (A), such excess shall, for purposes of this part, be treated as an amount to which section 904(c) applies.】

【(3)】 (2) PRE-CREDIT TENTATIVE MINIMUM TAX.—For purposes of this subsection, the term “pre-credit tentative minimum tax” means—

(A) * * *

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【(4)】 (3) ELECTION TO USE SIMPLIFIED SECTION 904 LIMITATION.—

(A) * * *

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Subchapter B—Computation of Taxable Income

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PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

Sec. 101. Certain death benefits.

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【Sec. 114. Extraterritorial income.】

* * * * *

Sec. 139A. Income attributable to films used outside the United States.

Sec. 139B. Exclusion from gross income for interest on overpayments of income tax by individuals.

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PART III—ITEMS SPECIALLY EXCLUDED FROM GROSS INCOME

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【SEC. 114. EXTRATERRITORIAL INCOME.

【(a) EXCLUSION.—Gross income does not include extraterritorial income.

【(b) EXCEPTION.—Subsection (a) shall not apply to extraterritorial income which is not qualifying foreign trade income as determined under subpart E of part III of subchapter N.

【(c) DISALLOWANCE OF DEDUCTIONS.—

【(1) IN GENERAL.—Any deduction of a taxpayer allocated under paragraph (2) to extraterritorial income of the taxpayer excluded from gross income under subsection (a) shall not be allowed.

【(2) ALLOCATION.—Any deduction of the taxpayer properly apportioned and allocated to the extraterritorial income derived by the taxpayer from any transaction shall be allocated on a proportionate basis between—

【(A) the extraterritorial income derived from such transaction which is excluded from gross income under subsection (a), and

【(B) the extraterritorial income derived from such transaction which is not so excluded.

[(d) DENIAL OF CREDITS FOR CERTAIN FOREIGN TAXES.—Notwithstanding any other provision of this chapter, no credit shall be allowed under this chapter for any income, war profits, and excess profits taxes paid or accrued to any foreign country or possession of the United States with respect to extraterritorial income which is excluded from gross income under subsection (a).

[(e) EXTRATERRITORIAL INCOME.—For purposes of this section, the term “extraterritorial income” means the gross income of the taxpayer attributable to foreign trading gross receipts (as defined in section 942) of the taxpayer.]

SEC. 121. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.

(a) * * *

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(d) SPECIAL RULES.—

(1) * * *

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(10) *PROPERTY ACQUIRED IN LIKE-KIND EXCHANGE.*—If a taxpayer acquired property in an exchange to which section 1031 applied, subsection (a) shall not apply to the sale or exchange of such property if it occurs during the 5-year period beginning with the date of the acquisition of such property.

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SEC. 139A. INCOME ATTRIBUTABLE TO FILMS USED OUTSIDE THE UNITED STATES.

(a) *EXCLUSION.*—

(1) *IN GENERAL.*—There shall be excluded from gross income an amount equal to the applicable percentage of qualified film income.

(2) *APPLICABLE PERCENTAGE.*—For purposes of paragraph (1), the applicable percentage shall be determined in accordance with the following table:

For taxable years ending in calendar year—	The applicable percentage is—
2007	1
2008	2
2009	3
2010	5
2011	8
2012	9
2013 or thereafter	10.

(b) *QUALIFIED FILM INCOME.*—For purposes of this section—

(1) *IN GENERAL.*—The term “qualified film income” means gross income from a license of a qualified film in the ordinary course of a trade or business for the exploitation or direct use outside the United States less any associated film costs.

(2) *EXCEPTIONS.*—

(A) *CERTAIN USES.*—Such term does not include exploitation of characters, soundtracks, designs, scripts, scores, or any other ancillary intangibles associated with the qualified film.

(B) *RELATED PERSON LICENSE.*—

(i) *IN GENERAL.*—Such term does not include any amount from the license of a qualified film to a related person.

(ii) *EXCEPTION.*—Clause (i) shall not apply if such film is held for license by such related person to an unrelated person for the direct use or exploitation by such unrelated person outside the United States.

(iii) *RELATED PERSON.*—For purposes of this subparagraph, a person shall be related to another person if such persons are treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414, except that determinations under subsections (a) and (b) of section 52 shall be made without regard to section 1563(b).

(c) *OTHER DEFINITIONS.*—For purposes of this section—

(1) *QUALIFIED FILM.*—The term “qualified film” means property described in section 168(f)(3) the original use of which commences after December 31, 2006, if not less than 50 percent of the total compensation relating to the production of such property is compensation for services performed in the United States by actors, production personnel, directors, and producers. Such term does not include property with respect to which records are required to be maintained under section 2257 of title 18, United States Code.

(2) *ASSOCIATED FILM COSTS.*—The term “associated film costs” means any expense properly apportioned and allocated to income taken into account under subsection (b)(1), determined as provided under regulations prescribed by the Secretary.

(d) *ELECTION.*—The taxpayer may elect not to apply this section to a qualified film. Such election shall be made by the due date (including extensions of time) for filing the return for the taxable year in which such film is placed in service, and, once made for such film, such election shall be irrevocable.

(e) *DENIAL OF FOREIGN TAX CREDIT.*—

(1) *IN GENERAL.*—No credit shall be allowed under section 901 for any taxes paid or accrued (or treated as paid or accrued) with respect to the excludable portion of any qualified film income. No deduction shall be allowed under this chapter for any tax for which credit is not allowable by reason of the preceding sentence.

(2) *EXCLUDABLE PORTION.*—For purposes of paragraph (1), the taxes paid or accrued (or treated as paid or accrued) with respect to the excludable portion is the amount which bears the same ratio to the amount of taxes paid or accrued (or treated as paid or accrued) with respect to qualified film income as the amount excluded under subsection (a) for the taxable year bears to the qualified film income for such year.

SEC. 139B. EXCLUSION FROM GROSS INCOME FOR INTEREST ON OVERPAYMENTS OF INCOME TAX BY INDIVIDUALS.

(a) *IN GENERAL.*—In the case of an individual, gross income shall not include interest paid under section 6611 on any overpayment of tax imposed by this subtitle.

(b) *EXCEPTION.*—Subsection (a) shall not apply in the case of a failure to claim items resulting in the overpayment on the original

return if the Secretary determines that the principal purpose of such failure is to take advantage of subsection (a).

(c) *SPECIAL RULE FOR DETERMINING MODIFIED ADJUSTED GROSS INCOME.*—For purposes of this title, interest not included in gross income under subsection (a) shall not be treated as interest which is exempt from tax for purposes of sections 32(i)(2)(B) and 6012(d) or any computation in which interest exempt from tax under this title is added to adjusted gross income.

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PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

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SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) * * *

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(m) CERTAIN EXCESSIVE EMPLOYEE REMUNERATION.—

(1) * * *

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(4) APPLICABLE EMPLOYEE REMUNERATION.—For purposes of this subsection—

(A) * * *

* * * * *

(G) *COORDINATION WITH EXCISE TAX ON SPECIFIED STOCK COMPENSATION.*—The dollar limitation contained in paragraph (1) with respect to any covered employee shall be reduced (but not below zero) by the amount of any payment (with respect to such employee) of the tax imposed by section 4985 directly or indirectly by the expatriated corporation (as defined in such section) or by any member of the expanded affiliated group (as defined in such section) which includes such corporation.

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SEC. 163. INTEREST.

(a) * * *

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(e) ORIGINAL ISSUE DISCOUNT.—

(1) * * *

* * * * *

(3) SPECIAL RULE FOR ORIGINAL ISSUE DISCOUNT ON OBLIGATION HELD BY RELATED FOREIGN PERSON.—

(A) * * *

(B) *SPECIAL RULE FOR CERTAIN FOREIGN ENTITIES.*—

(i) *IN GENERAL.*—In the case of any debt instrument having original issue discount which is held by a related foreign person which is a foreign personal holding company (as defined in section 552), a controlled foreign corporation (as defined in section 957), or a passive foreign investment company (as defined in

section 1297), a deduction shall be allowable to the issuer with respect to such original issue discount for any taxable year before the taxable year in which paid only to the extent such original issue discount is included during such prior taxable year in the gross income of a United States person who owns (within the meaning of section 958(a)) stock in such corporation.

(ii) SECRETARIAL AUTHORITY.—The Secretary may by regulation exempt transactions from the application of clause (i), including any transaction which is entered into by a payor in the ordinary course of a trade or business in which the payor is predominantly engaged.

[(B)] (C) RELATED FOREIGN PERSON.—For purposes of subparagraph (A), the term “related foreign person” means any person—

- (i) who is not a United States person, and
- (ii) who is related (within the meaning of section 267(b)) to the issuer.

[Note: The amendment made by section 1074(c)(34) of H.R. 2896 to section 163(e)(3)(B) (shown below) applies to taxable years of foreign corporations beginning after December 31, 2006, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.]

(e) ORIGINAL ISSUE DISCOUNT.—

(1) * * *

* * * * *

(3) SPECIAL RULE FOR ORIGINAL ISSUE DISCOUNT ON OBLIGATION HELD BY RELATED FOREIGN PERSON.—

(A) * * *

(B) SPECIAL RULE FOR CERTAIN FOREIGN ENTITIES.—

(i) IN GENERAL.—In the case of any debt instrument having original issue discount which is held by a related foreign person which is a controlled foreign corporation (as defined in section 957) or a passive foreign investment company (as defined in section 1297), a deduction shall be allowable to the issuer with respect to such original issue discount for any taxable year before the taxable year in which paid only to the extent such original issue discount is included during such prior taxable year in the gross income of a United States person who owns (within the meaning of section 958(a)) stock in such corporation.

(ii) SECRETARIAL AUTHORITY.—The Secretary may by regulation exempt transactions from the application of clause (i), including any transaction which is entered into by a payor in the ordinary course of a trade or business in which the payor is predominantly engaged.

* * * * *

(j) LIMITATION ON DEDUCTION FOR INTEREST ON CERTAIN INDEBTEDNESS.—

[(1) LIMITATION.—

【(A) IN GENERAL.—If this subsection applies to any corporation for any taxable year, no deduction shall be allowed under this chapter for disqualified interest paid or accrued by such corporation during such taxable year. The amount disallowed under the preceding sentence shall not exceed the corporation's excess interest expense for the taxable year.

【(B) DISALLOWED AMOUNT CARRIED TO SUCCEEDING TAXABLE YEAR.—Any amount disallowed under subparagraph (A) for any taxable year shall be treated as disqualified interest paid or accrued in the succeeding taxable year (and clause (ii) of paragraph (2)(A) shall not apply for purposes of applying this subsection to the amount so treated).

【(2) CORPORATIONS TO WHICH SUBSECTION APPLIES.—

【(A) IN GENERAL.—This subsection shall apply to any corporation for any taxable year if—

【(i) such corporation has excess interest expense for such taxable year, and

【(ii) the ratio of debt to equity of such corporation as of the close of such taxable year (or on any other day during the taxable year as the Secretary may by regulations prescribe) exceeds 1.5 to 1.

【(B) EXCESS INTEREST EXPENSE.—

【(i) IN GENERAL.—For purposes of this subsection, the term “excess interest expense” means the excess (if any) of—

【(I) the corporation's net interest expense, over

【(II) the sum of 50 percent of the adjusted taxable income of the corporation plus any excess limitation carryforward under clause (ii).

【(ii) EXCESS LIMITATION CARRYFORWARD.—If a corporation has an excess limitation for any taxable year, the amount of such excess limitation shall be an excess limitation carryforward to the 1st succeeding taxable year and to the 2nd and 3rd succeeding taxable years to the extent not previously taken into account under this clause. The amount of such a carryforward taken into account for any such succeeding taxable year shall not exceed the excess interest expense for such succeeding taxable year (determined without regard to the carryforward from the taxable year of such excess limitation).

【(iii) EXCESS LIMITATION.—For purposes of clause (ii), the term “excess limitation” means the excess (if any) of—

【(I) 50 percent of the adjusted taxable income of the corporation, over

【(II) the corporation's net interest expense.

【(C) RATIO OF DEBT TO EQUITY.—For purposes of this paragraph, the term “ratio of debt to equity” means the ratio which the total indebtedness of the corporation bears to the sum of its money and all other assets reduced (but

not below zero) by such total indebtedness. For purposes of the preceding sentence—

[(i) the amount taken into account with respect to any asset shall be the adjusted basis thereof for purposes of determining gain,

[(ii) the amount taken into account with respect to any indebtedness with original issue discount shall be its issue price plus the portion of the original issue discount previously accrued as determined under the rules of section 1272 (determined without regard to subsection (a)(7) or (b)(4) thereof), and

[(iii) there shall be such other adjustments as the Secretary may by regulations prescribe.]

(1) *LIMITATION.*—

(A) *IN GENERAL.*—*In the case of a corporation, no deduction shall be allowed under this chapter for disqualified interest paid or accrued during the taxable year.*

(B) *MAXIMUM DISALLOWANCE.*—*The amount disallowed under subparagraph (A) shall not exceed the sum of—*

(i) the corporation's excess interest expense for the taxable year, and

(ii) the corporation's excess related party interest expense for such year.

In no event shall the disallowance under subparagraph (A) reduce the deduction for interest below the sum of the amount of interest includible in the gross income of the taxpayer for such taxable year and an amount equal to 25 percent of adjusted taxable income (35 percent in the case of the first taxable year beginning after December 31, 2003).

(C) *DISALLOWED AMOUNT CARRIED TO SUCCEEDING TAXABLE YEAR.*—

(i) IN GENERAL.—*Any amount disallowed under subparagraph (A) for any taxable year shall be treated as paid or accrued in the succeeding taxable year and in the 2nd through 10th succeeding taxable years to the extent not previously taken into account under this subparagraph.*

(ii) LIMITATION ON AMOUNT CARRIED TO YEAR.—*A carryforward amount may not be taken into account for any such succeeding taxable year to the extent that such amount, when added to amounts carried to such succeeding taxable year from taxable years preceding the taxable year from which the amount is being carried forward, would result in (or increase) a disallowance under subparagraph (A).*

(iii) CARRYOVER APPLIED SEPARATELY TO CATEGORIES OF DISQUALIFIED INTEREST.—*Clauses (i) and (ii) shall be applied separately to disqualified interest described in paragraph (3)(A) and to disqualified interest described in paragraph (3)(B). For purposes of this subparagraph, any amount disallowed under subparagraph (A) for any taxable year shall be treated as disqualified interest described in paragraph (3)(A) to the*

extent thereof and then as disqualified interest described in paragraph (3)(B).

(2) *EXCESS INTEREST EXPENSE; EXCESS RELATED PARTY INTEREST EXPENSE.*—For purposes of this subsection—

(A) *EXCESS INTEREST EXPENSE.*—The term “excess interest expense” means the excess (if any) of—

(i) *the corporation’s net interest expense, over*

(ii) *50 percent of the adjusted taxable income of the corporation.*

(B) *EXCESS RELATED PARTY INTEREST EXPENSE.*—The term “excess related party interest expense” means the excess (if any) of—

(i) *the lesser of—*

(I) *the amount of disqualified interest described in paragraph (3)(A), or*

(II) *the corporation’s net interest expense, over 25 percent (35 percent in the case of the first taxable year beginning after December 31, 2003) of the adjusted taxable income of the corporation.*

(3) *ALTERNATIVE MAXIMUM DISALLOWANCE.*—

(A) *IN GENERAL.*—In the case of a corporation with respect to which an election is in effect under subparagraph (B), the amount disallowed under paragraph (1)(A) shall not exceed the excess (if any) of—

(i) *the corporation’s net interest expense, over*

(ii) *30 percent of the adjusted taxable income of the corporation.*

(B) *ELECTION.*—A corporation may make a one-time irrevocable election to have the alternative maximum disallowance described in subparagraph (A) apply for purposes of this subsection in lieu of paragraph (1)(B). An election under this subparagraph shall not apply with respect to any taxable year beginning before January 1, 2005.

(C) *LIMITATION.*—Subparagraph (B) shall not apply with respect to any corporation which is—

(i) *a surrogate foreign corporation (as defined in section 7874(a)(2)(B)),*

(ii) *a corporation which would be a surrogate foreign corporation (as so defined) if “December 31, 1996” were substituted for “March 4, 2003” in section 7874(a), or*

(iii) *a corporation which is an expatriated entity (as defined in section 7874(a)) with respect to a corporation described in clause (i) or (ii).*

[(3)] (4) *DISQUALIFIED INTEREST.*—For purposes of this subsection, the term “disqualified interest” means—

(A) *any interest paid or accrued by the taxpayer (directly or indirectly) to a related person if no tax is imposed by this subtitle with respect to such interest, and*

(B) *any interest paid or accrued by the taxpayer with respect to any indebtedness to a person who is not a related person if—*

(i) * * *

(ii) no gross basis tax is imposed by this subtitle with respect to such interest[, and].

[(C) any interest paid or accrued (directly or indirectly) by a taxable REIT subsidiary (as defined in section 856(l)) of a real estate investment trust to such trust.]

[(4)] (5) RELATED PERSON.—For purposes of this subsection—

(A) * * *

(B) SPECIAL RULE FOR CERTAIN PARTNERSHIPS.—

(i) * * *

(ii) SPECIAL RULE WHERE TREATY REDUCTION.—If any treaty between the United States and any foreign country reduces the rate of tax imposed by this subtitle on a partner's share of any interest paid or accrued to a partnership, such partner's interests in such partnership shall, for purposes of clause (i), be treated as held in part by a tax-exempt person and in part by a taxable person under rules similar to the rules of paragraph [(5)(B)] (6)(B).

* * * * *

[(5)] (6) SPECIAL RULES FOR DETERMINING WHETHER INTEREST IS SUBJECT TO TAX.—

(A) * * *

* * * * *

[(6)] (7) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) * * *

* * * * *

[(7)] (8) COORDINATION WITH PASSIVE LOSS RULES, ETC.—This subsection shall be applied before sections 465 and 469.

[(8)] (9) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection, including—

(A) * * *

* * * * *

(m) *INTEREST ON UNPAID TAXES ATTRIBUTABLE TO NONDISCLOSED REPORTABLE TRANSACTIONS.*—No deduction shall be allowed under this chapter for any interest paid or accrued under section 6601 on any underpayment of tax which is attributable to the portion of any reportable transaction understatement (as defined in section 6662A(b)) with respect to which the requirement of section 6664(d)(2)(A) is not met.

[(m)] (n) CROSS REFERENCES.—

(1) * * *

* * * * *

SEC. 168. ACCELERATED COST RECOVERY SYSTEM.

(a) * * *

(b) APPLICABLE DEPRECIATION METHOD.—For purposes of this section—

(1) * * *

(2) 150 percent declining balance method in certain cases

Paragraph (1) shall be applied by substituting “150 percent” for “200 percent” in the case of—

(A) any 15-year or 20-year property *not referred to in paragraph (3)*,

* * * * *

(3) PROPERTY TO WHICH STRAIGHT LINE METHOD APPLIES.—The applicable depreciation method shall be the straight line method in the case of the following property:

(A) * * *

* * * * *

(G) *Qualified leasehold improvement property described in subsection (e)(6).*

(H) *Qualified restaurant property described in subsection (e)(7).*

* * * * *

(e) CLASSIFICATION OF PROPERTY.—For purposes of this section—

(1) * * *

* * * * *

(3) CLASSIFICATION OF CERTAIN PROPERTY.—

(A) * * *

* * * * *

(E) 15-YEAR PROPERTY.—The term “15-year property” includes—

(i) * * *

(ii) any telephone distribution plant and comparable equipment used for 2-way exchange of voice and data communications, **[and]**

(iii) any section 1250 property which is a retail motor fuels outlet (whether or not food or other convenience items are sold at the outlet) **[.]**,

(iv) *any qualified leasehold improvement property placed in service before January 1, 2006, and*

(v) *any qualified restaurant property placed in service before January 1, 2006.*

* * * * *

(6) QUALIFIED LEASEHOLD IMPROVEMENT PROPERTY.—The term “qualified leasehold improvement property” has the meaning given such term in section 168(k)(3) except that the following special rules shall apply:

(A) IMPROVEMENTS MADE BY LESSOR.—In the case of an improvement made by the person who was the lessor of such improvement when such improvement was placed in service, such improvement shall be qualified leasehold improvement property (if at all) only so long as such improvement is held by such person.

(B) EXCEPTION FOR CHANGES IN FORM OF BUSINESS.—Property shall not cease to be qualified leasehold improvement property under subparagraph (A) by reason of—

(i) death,

(ii) a transaction to which section 381(a) applies,

(iii) a mere change in the form of conducting the trade or business so long as the property is retained in such trade or business as qualified leasehold improvement property and the taxpayer retains a substantial interest in such trade or business,

(iv) the acquisition of such property in an exchange described in section 1031, 1033, or 1038 to the extent that the basis of such property includes an amount representing the adjusted basis of other property owned by the taxpayer or a related person, or

(v) the acquisition of such property by the taxpayer in a transaction described in section 332, 351, 361, 721, or 731 (or the acquisition of such property by the taxpayer from the transferee or acquiring corporation in a transaction described in such section), to the extent that the basis of the property in the hands of the taxpayer is determined by reference to its basis in the hands of the transferor or distributor.

(7) **QUALIFIED RESTAURANT PROPERTY.**—The term “qualified restaurant property” means any section 1250 property which is an improvement to a building if—

(A) such improvement is placed in service more than 3 years after the date such building was first placed in service, and

(B) more than 50 percent of the building’s square footage is devoted to preparation of, and seating for on-premises consumption of, prepared meals.

* * * * *

(g) **ALTERNATIVE DEPRECIATION SYSTEM FOR CERTAIN PROPERTY.**—

(1) * * *

* * * * *

(3) **SPECIAL RULES FOR DETERMINING CLASS LIFE.**—

(A) * * *

(B) **SPECIAL RULE FOR CERTAIN PROPERTY ASSIGNED TO CLASSES.**—For purposes of paragraph (2), in the case of property described in any of the following subparagraphs of subsection (e)(3), the class life shall be determined as follows:

If property is described in subparagraph:	The class life is:
(A)(iii)	4
(B)(ii)	5
(B)(iii)	9.5
(C)(i)	10
(D)(i)	15
(D)(ii)	20
(E)(i)	24
(E)(ii)	24
(E)(iii)	20
(E)(iv)	39
(E)(v)	39

* * * * *

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) * * *

* * * * *

(f) **DISALLOWANCE OF DEDUCTION IN CERTAIN CASES AND SPECIAL RULES.—**

(1) * * *

* * * * *

(10) **SPLIT-DOLLAR LIFE INSURANCE, ANNUITY, AND ENDOWMENT CONTRACTS.—**

(A) **IN GENERAL.**—Nothing in this section or in section 545(b)(2), **[556(b)(2),]** 642(c), 2055, 2106(a)(2), or 2522 shall be construed to allow a deduction, and no deduction shall be allowed, for any transfer to or for the use of an organization described in subsection (c) if in connection with such transfer—

(i) * * *

* * * * *

SEC. 171. AMORTIZABLE BOND PREMIUM.

(a) * * *

* * * * *

(c) **ELECTION AS TO TAXABLE BONDS.—**

(1) * * *

(2) **MANNER AND EFFECT OF ELECTION.**—The election authorized under this subsection shall be made in accordance with such regulations as the Secretary shall prescribe. If such election is made with respect to any bond (described in paragraph (1)) of the taxpayer, it shall also apply to all such bonds held by the taxpayer at the beginning of the first taxable year to which the election applies and to all such bonds thereafter acquired by him and shall be binding for all subsequent taxable years with respect to all such bonds of the taxpayer, unless, on application by the taxpayer, the Secretary permits him, subject to such conditions as the Secretary deems necessary, to revoke such election. In the case of bonds held by a common trust fund, as defined in section 584(a)**[, or by a foreign personal holding company, as defined in section 552],** the election authorized under this subsection shall be exercisable with respect to such bonds only by the common trust fund **[or foreign personal holding company]**. In case of bonds held by an estate or trust, the election authorized under this subsection shall be exercisable with respect to such bonds only by the fiduciary.

* * * * *

SEC. 179. ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS.

(a) * * *

(b) **LIMITATIONS.—**

(1) **DOLLAR LIMITATION.**—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed \$25,000 (\$100,000 in the case of taxable years beginning after 2002 and before **[2006]** 2008).

(2) REDUCTION IN LIMITATION.—The limitation under paragraph (1) for any taxable year shall be reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during such taxable year exceeds \$200,000 (\$400,000 in the case of taxable years beginning after 2002 and before **[2006]** 2008).

* * * * *

(5) INFLATION ADJUSTMENTS.—

(A) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2003 and before **[2006]** 2008, the \$100,000 and \$400,000 amounts in paragraphs (1) and (2) shall each be increased by an amount equal to—

(i) * * *

* * * * *

(c) ELECTION.—

(1) * * *

(2) ELECTION IRREVOCABLE.—Any election made under this section, and any specification contained in any such election, may not be revoked except with the consent of the Secretary. Any such election or specification with respect to any taxable year beginning after 2002 and before **[2006]** 2008 may be revoked by the taxpayer with respect to any property, and such revocation, once made, shall be irrevocable.

(d) DEFINITIONS AND SPECIAL RULES.—

(1) SECTION 179 PROPERTY.—For purposes of this section, the term “section 179 property” means property—

(A) which is—

(i) * * *

(ii) computer software (as defined in section 197(e)(3)(B)) which is described in section 197(e)(3)(A)(i), to which section 167 applies, and which is placed in service in a taxable year beginning after 2002 and before **[2006]** 2008,

* * * * *

PART VIII—SPECIAL DEDUCTION FOR CORPORATIONS

* * * * *

SEC. 245. DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS

(a) DIVIDENDS FROM 10-PERCENT OWNED FOREIGN CORPORATIONS.—

(1) * * *

(2) QUALIFIED 10-PERCENT OWNED FOREIGN CORPORATION.—

For purposes of this subsection, the term “qualified 10-percent owned foreign corporation” means any foreign corporation (other than a **[foreign personal holding company or]** passive foreign investment company) if at least 10 percent of the stock of such corporation (by vote and value) is owned by the taxpayer.

* * * * *

PART IX—ITEMS NOT DEDUCTIBLE

* * * * *

**SEC. 267. LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO
TRANSACTIONS BETWEEN RELATED TAXPAYERS.**

(a) IN GENERAL.—**(1) * * ***

* * * * *

(3) PAYMENTS TO FOREIGN PERSONS.—[The Secretary]

(A) IN GENERAL.—The Secretary shall by regulations apply the matching principle of paragraph (2) in cases in which the person to whom the payment is to be made is not a United States person.

(B) SPECIAL RULE FOR CERTAIN FOREIGN ENTITIES.—

(i) IN GENERAL.—Notwithstanding subparagraph (A), in the case of any amount payable to a foreign personal holding company (as defined in section 552), a controlled foreign corporation (as defined in section 957), or a passive foreign investment company (as defined in section 1297), a deduction shall be allowable to the payor with respect to such amount for any taxable year before the taxable year in which paid only to the extent such amount is included during such prior taxable year in the gross income of a United States person who owns (within the meaning of section 958(a)) stock in such corporation.

(ii) SECRETARIAL AUTHORITY.—The Secretary may by regulation exempt transactions from the application of clause (i), including any transaction which is entered into by a payor in the ordinary course of a trade or business in which the payor is predominantly engaged and in which the payment of the accrued amounts occurs within 8½ months after accrual or within such other period as the Secretary may prescribe.

[Note: The amendment made by section 1074(c)(34) of H.R. 2896 to section 267(a)(3)(B)(i) (shown below) applies to taxable years of foreign corporations beginning after December 31, 2006, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.]

**SEC. 267. LOSSES, EXPENSES, AND INTEREST WITH RESPECT TO
TRANSACTIONS BETWEEN RELATED TAXPAYERS.**

(a) IN GENERAL.—**(1) * * ***

* * * * *

(3) PAYMENTS TO FOREIGN PERSONS.—**(A) * * ******(B) SPECIAL RULE FOR CERTAIN FOREIGN ENTITIES.—***

(i) IN GENERAL.—Notwithstanding subparagraph (A), in the case of any amount payable to a controlled foreign corporation (as defined in section 957) or a passive foreign investment company (as defined in section 1297), a deduction shall be allowable to the payor with respect to such amount for any taxable year before the

taxable year in which paid only to the extent such amount is included during such prior taxable year in the gross income of a United States person who owns (within the meaning of section 958(a)) stock in such corporation.

* * * * *

SEC. 275. CERTAIN TAXES.

(a) GENERAL RULE.—No deduction shall be allowed for the following taxes:

(1) * * *

* * * * *

(6) TAXES IMPOSED BY CHAPTERS 41, 42, 43, 44, 45, 46, AND 54.—Paragraph (1) shall not apply to any taxes to the extent such taxes are allowable as a deduction under section 164(f). Paragraph (1) shall not apply to the tax imposed by section 59A.

* * * * *

Subchapter C—Corporate Distributions and Adjustments

* * * * *

PART I—DISTRIBUTIONS BY CORPORATIONS

* * * * *

Subpart B—Effects on Corporation

* * * * *

SEC. 312. EFFECT ON EARNINGS AND PROFITS.

(a) * * *

* * * * *

[(j) EARNINGS AND PROFITS OF FOREIGN INVESTMENT COMPANIES.—

[(1) ALLOCATION WITHIN AFFILIATED GROUP.—In the case of a sale or exchange of stock in a foreign investment company (as defined in section 1246(b)) by a United States person (as defined in section 7701(a)(30)), if such company is a member of an affiliated group, then the accumulated earnings and profits of all members of such affiliated group shall be allocated, under regulations prescribed by the Secretary, in such manner as is proper to carry out the purposes of section 1246.

[(2) AFFILIATED GROUP DEFINED.—For purposes of paragraph (1) of this subsection, the term “affiliated group” has the meaning assigned to such term by section 1504(a); except that (A) “more than 50 percent” shall be substituted for “80 percent or more”, and (B) all corporations shall be treated as includible corporations (without regard to the provisions of section 1504(b)).]

* * * * *

(m) NO ADJUSTMENT FOR INTEREST PAID ON CERTAIN REGISTRATION-REQUIRED OBLIGATIONS NOT IN REGISTERED FORM.—The earnings and profits of any corporation shall not be decreased by any interest with respect to which a deduction is not or would not be allowable by reason of section 163(f), unless at the time of issuance the issuer is a foreign corporation that is not a controlled foreign corporation (within the meaning of section 957), a foreign investment company (within the meaning of section 1246(b)), or a foreign personal holding company (within the meaning of section 552) and the issuance did not have as a purpose the avoidance of section 163(f) or this subsection.

* * * * *

PART II—CORPORATE LIQUIDATIONS

* * * * *

Subpart B—Effects on Corporation

* * * * *

SEC. 338. CERTAIN STOCK PURCHASES TREATED AS ASSET ACQUISITIONS.

(a) * * *

* * * * *

(h) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) * * *

* * * * *

(13) TAX ON DEEMED SALE NOT TAKEN INTO ACCOUNT FOR ESTIMATED TAX PURPOSES.—For purposes of section 6655, tax attributable to the sale described in subsection (a)(1) shall not be taken into account. *The preceding sentence shall not apply with respect to a qualified stock purchase for which an election is made under paragraph (10).*

* * * * *

PART III—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

* * * * *

Subpart C—Effects on Corporations

* * * * *

SEC. 362. BASIS TO CORPORATIONS.

(a) * * *

* * * * *

(e) LIMITATION ON TRANSFER OF BUILT-IN LOSSES ON REMIC RESIDUALS IN SECTION 351 TRANSACTIONS.—If—

(1) a residual interest (as defined in section 860G(a)(2)) in a REMIC is transferred in any transaction which is described in subsection (a), and

(2) *the transferee's adjusted basis in such residual interest would (but for this paragraph) exceed its fair market value immediately after such transaction, then, notwithstanding subsection (a), the transferee's adjusted basis in such residual interest shall not exceed its fair market value (whether or not greater than zero) immediately after such transaction.*

* * * * *

Subpart D—Special Rule; Definitions

* * * * *

SEC. 367. FOREIGN CORPORATIONS

(a) * * *

* * * * *

(d) **SPECIAL RULES RELATING TO TRANSFERS OF INTANGIBLES.—**

(1) * * *

(2) **TRANSFER OF INTANGIBLES TREATED AS TRANSFER PURSUANT TO SALE OF CONTINGENT PAYMENTS.—**

(A) * * *

* * * * *

(C) **AMOUNTS RECEIVED TREATED AS ORDINARY INCOME.**—For purposes of this chapter, any amount included in gross income by reason of this subsection shall be treated as ordinary income. *For purposes of applying section 904(d), any such amount shall be treated in the same manner as if such amount were a royalty.*

* * * * *

PART V—CARRYOVERS

* * * * *

SEC. 382. LIMITATION ON NET OPERATING LOSS CARRYFORWARDS AND CERTAIN BUILT-IN LOSSES FOLLOWING OWNERSHIP CHANGE.

(a) * * *

* * * * *

(l) **CERTAIN ADDITIONAL OPERATING RULES.**—For purposes of this section—

(1) * * *

* * * * *

(4) **REDUCTION IN VALUE WHERE SUBSTANTIAL NONBUSINESS ASSETS.—**

(A) * * *

(B) **CORPORATION HAVING SUBSTANTIAL NONBUSINESS ASSETS.**—For purposes of subparagraph (A)—

(i) * * *

(ii) **EXCEPTION FOR CERTAIN INVESTMENT ENTITIES.**—A regulated investment company to which part I of subchapter M applies, a real estate investment trust to which part II of subchapter M applies, [a REMIC to which part IV of subchapter M applies, or

a FASIT to which part V of subchapter M applies,¹ or a REMIC to which part IV of subchapter M applies, shall not be treated as a new loss corporation having substantial nonbusiness assets.

* * * * *

Subchapter D—Deferred Compensation, Etc.

* * * * *

PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

* * * * *

Subpart A—General Rule

Sec. 401. Qualified pension, profit-sharing, and stock bonus plans.

* * * * *

Sec. 409A. Inclusion in gross income of deferred compensation under nonqualified deferred compensation plans.

* * * * *

SEC. 409A. INCLUSION IN GROSS INCOME OF DEFERRED COMPENSATION UNDER NONQUALIFIED DEFERRED COMPENSATION PLANS.

(a) RULES RELATING TO CONSTRUCTIVE RECEIPT.—

(1) IN GENERAL.—

(A) GROSS INCOME INCLUSION.—*In the case of a non-qualified deferred compensation plan, all compensation deferred under the plan for all taxable years (to the extent not subject to a substantial risk of forfeiture and not previously included in gross income) shall be includible in gross income for the taxable year unless at all times during the taxable year the plan meets the requirements of paragraphs (2), (3), and (4) and is operated in accordance with such requirements.*

(B) INTEREST ON TAX LIABILITY PAYABLE WITH RESPECT TO PREVIOUSLY DEFERRED COMPENSATION.—

(i) IN GENERAL.—*If compensation is required to be included in gross income under subparagraph (A) for a taxable year, the tax imposed by this chapter for such taxable year shall be increased by the amount of interest determined under clause (ii).*

(ii) INTEREST.—*For purposes of clause (i), the interest determined under this clause for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the deferred compensation been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture.*

(2) DISTRIBUTIONS.—

(A) *IN GENERAL.*—The requirements of this paragraph are met if the plan provides that compensation deferred under the plan may not be distributed earlier than—

(i) separation from service as determined by the Secretary (except as provided in subparagraph (B)(i)),

(ii) disability (as defined by section 223(d) of the Social Security Act),

(iii) death,

(iv) a specified time (or pursuant to a fixed schedule) specified under the plan at the date of the deferral of such compensation,

(v) to the extent provided by the Secretary, a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation, or

(vi) the occurrence of an unforeseeable emergency.

(B) *SPECIAL RULES.*—

(i) *SPECIFIED EMPLOYEES.*—In the case of specified employees, the requirement of subparagraph (A)(i) is met only if distributions may not be made earlier than 6 months after the date of separation from service. For purposes of the preceding sentence, a specified employee is a key employee (as defined in section 416(i)) of a corporation the stock in which is publicly traded on an established securities market or otherwise.

(ii) *UNFORESEEABLE EMERGENCY.*—For purposes of subparagraph (A)(vi)—

(I) *IN GENERAL.*—The term “unforeseeable emergency” means a severe financial hardship to the participant resulting from a sudden and unexpected illness or accident of the participant, the participant’s spouse, or a dependent (as defined in section 152(a)) of the participant, loss of the participant’s property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

(II) *LIMITATION ON DISTRIBUTIONS.*—The requirement of subparagraph (A)(vi) is met only if, as determined under regulations of the Secretary, the amounts distributed with respect to an emergency do not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the participant’s assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

(3) *ACCELERATION OF BENEFITS.*—The requirements of this paragraph are met if the plan does not permit the acceleration of the time or schedule of any payment under the plan, except as provided in regulations by the Secretary.

(4) *ELECTIONS.*—

(A) *IN GENERAL.*—*The requirements of this paragraph are met if the requirements of subparagraphs (B) and (C) are met.*

(B) *INITIAL DEFERRAL DECISION.*—*The requirements of this subparagraph are met if the plan provides that compensation for services performed during a taxable year may be deferred at the participant's election only if the election to defer such compensation is made during the preceding taxable year or at such other time as provided in regulations. In the case of the first year in which a participant becomes eligible to participate in the plan, such election may be made with respect to services to be performed subsequent to the election within 30 days after the date the participant becomes eligible to participate in such plan.*

(C) *CHANGES IN TIME AND FORM OF DISTRIBUTION.*—*The requirements of this subparagraph are met if, in the case of a plan which permits under a subsequent election a delay in a payment or a change in the form of payment—*

(i) the plan requires that such election may not take effect until at least 12 months after the date on which the election is made,

(ii) in the case an election related to a payment not described in clause (ii), (iii), or (vi) of paragraph (2)(A), the plan requires that the first payment with respect to which such election is made be deferred for a period of not less than 5 years from the date such payment would otherwise have been made, and

(iii) the plan requires that any election related to a payment described in paragraph (2)(A)(iv) may not be made less than 12 months prior to the date of the first scheduled payment under such paragraph.

(b) *RULES RELATING TO FUNDING.*—

(1) *OFFSHORE PROPERTY IN A TRUST.*—*In the case of assets held in a trust or set aside (directly or indirectly) in another arrangement, as determined by the Secretary, for purposes of paying deferred compensation under a nonqualified deferred compensation plan, for purposes of section 83 such assets shall be treated as property transferred in connection with the performance of services whether or not such assets are available to satisfy claims of general creditors—*

(A) at the time set aside if such assets are located outside of the United States, or

(B) at the time transferred if such assets are subsequently transferred outside of the United States.

(2) *EMPLOYER'S FINANCIAL HEALTH.*—*In the case of a nonqualified deferred compensation plan, there is a transfer of property within the meaning of section 83 as of the earlier of—*

(A) the date on which the plan first provides that assets will become restricted to the provision of benefits under the plan in connection with a change in the employer's financial health, or

(B) the date on which assets are so restricted.

(3) *INCOME INCLUSION FOR OFFSHORE TRUSTS AND EMPLOYER'S FINANCIAL HEALTH.*—For each taxable year that assets treated as transferred under this subsection remain set aside in a trust or other arrangement subject to paragraph (1) or (2), any increase in value in, or earnings with respect to, such assets shall be treated as an additional transfer of property under this subsection (to the extent not previously included in income).

(4) *INTEREST ON TAX LIABILITY PAYABLE WITH RESPECT TO TRANSFERRED PROPERTY.*—

(A) *IN GENERAL.*—If amounts are required to be included in gross income by reason of paragraph (1) or (2) for a taxable year, the tax imposed by this chapter for such taxable year shall be increased by the amount of interest determined under subparagraph (B).

(B) *INTEREST.*—The interest determined under this subparagraph for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the amounts so required to be included in gross income by paragraph (1) or (2) been includible in gross income for the taxable year in which such assets were first set aside (directly or indirectly) in a trust (or other arrangement determined by the Secretary) for purposes of the nonqualified deferred compensation plan.

(c) *NO INFERENCE ON EARLIER INCOME INCLUSION OR REQUIREMENT OF LATER INCLUSION.*—Nothing in this section shall be construed to prevent the inclusion of amounts in gross income under any other provision of this chapter or any other rule of law earlier than the time provided in this section. Any amount included in gross income under this section shall not be required to be included in gross income under any other provision of this chapter or any other rule of law later than the time provided in this section.

(d) *OTHER DEFINITIONS AND SPECIAL RULES.*—For purposes of this section—

(1) *NONQUALIFIED DEFERRED COMPENSATION PLAN.*—The term “nonqualified deferred compensation plan” means any plan that provides for the deferral of compensation, other than—

(A) a qualified employer plan, and

(B) any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.

(2) *QUALIFIED EMPLOYER PLAN.*—The term “qualified employer plan” means—

(A) any plan, contract, pension, account, or trust described in subparagraph (A) or (B) of section 219(g)(5), and

(B) any eligible deferred compensation plan (within the meaning of section 457(b)) of an employer described in section 457(e)(1)(A).

(3) *PLAN INCLUDES ARRANGEMENTS, ETC.*—The term “plan” includes any agreement or arrangement, including an agreement or arrangement that includes one person.

(4) *SUBSTANTIAL RISK OF FORFEITURE.*—The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are condi-

tioned upon the future performance of substantial services by any individual.

(5) TREATMENT OF EARNINGS.—References to deferred compensation shall be treated as including references to income (whether actual or notional) attributable to such compensation or such income.

(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

(1) providing for the determination of amounts of deferral in the case of a nonqualified deferred compensation plan which is a defined benefit plan,

(2) relating to changes in the ownership and control of a corporation or assets of a corporation for purposes of subsection (a)(2)(A)(v),

(3) exempting arrangements from the application of subsection (b) if such arrangements will not result in an improper deferral of United States tax and will not result in assets being effectively beyond the reach of creditors,

(4) defining financial health for purposes of subsection (b)(2), and

(5) disregarding a substantial risk of forfeiture in cases where necessary to carry out the purposes of this section.

* * * * *

Subpart B—Special Rules

* * * * *

SEC. 414. DEFINITIONS AND SPECIAL RULES.

*(a) * * **

(b) EMPLOYEES OF CONTROLLED GROUP OF CORPORATIONS.—For purposes of sections 401, 408(k), 408(p), 409A, 410, 411, 415, and 416, all employees of all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a), determined without regard to section 1563(a)(4) and (e)(3)(C)) shall be treated as employed by a single employer. With respect to a plan adopted by more than one such corporation, the applicable limitations provided by section 404(a) shall be determined as if all such employers were a single employer, and allocated to each employer in accordance with regulations prescribed by the Secretary.

(c) EMPLOYEES OF PARTNERSHIPS, PROPRIETORSHIPS, ETC., WHICH ARE UNDER COMMON CONTROL.—For purposes of sections 401, 408(k), 408(p), 409A, 410, 411, 415, and 416, under regulations prescribed by the Secretary, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer. The regulations prescribed under this subsection shall be based on principles similar to the principles which apply in the case of subsection (b).

* * * * *

**Subpart E—Transfer of Excess Pension Assets to Retiree
Health Accounts**

* * * * *

**SEC. 420. TRANSFERS OF EXCESS PENSION ASSETS TO RETIREE
HEALTH ACCOUNTS.**

(a) * * *

(b) QUALIFIED TRANSFER.—For purposes of this section—

(1) * * *

* * * * *

(5) EXPIRATION.—No transfer made after December 31, **[2005] 2013**, shall be treated as a qualified transfer.

* * * * *

PART II—CERTAIN STOCK OPTIONS

* * * * *

SEC. 421. GENERAL RULES.

(a) * * *

(b) EFFECT OF DISQUALIFYING DISPOSITION.—If the transfer of a share of stock to an individual pursuant to his exercise of an option would otherwise meet the requirements of section 422(a) or 423(a) except that there is a failure to meet any of the holding period requirements of section 422(a)(1) or 423(a)(1), then any increase in the income of such individual or deduction from the income of his employer corporation for the taxable year in which such exercise occurred attributable to such disposition, shall be treated as an increase in income or a deduction from income in the taxable year of such individual or of such employer corporation in which such disposition occurred. *No amount shall be required to be deducted and withheld under chapter 24 with respect to any increase in income attributable to a disposition described in the preceding sentence.*

* * * * *

SEC. 423. EMPLOYEE STOCK PURCHASE PLANS.

(a) * * *

* * * * *

(c) SPECIAL RULE WHERE OPTION PRICE IS BETWEEN 85 PERCENT AND 100 PERCENT OF VALUE OF STOCK.—If the option price of a share of stock acquired by an individual pursuant to a transfer to which subsection (a) applies was less than 100 percent of the fair market value of such share at the time such option was granted, then, in the event of any disposition of such share by him which meets the holding period requirements of subsection (a), or in the event of his death (whenever occurring) while owning such share, there shall be included as compensation (and not as gain upon the sale or exchange of a capital asset) in his gross income, for the taxable year in which falls the date of such disposition or for the taxable year closing with his death, whichever applies, an amount equal to the lesser of—

(1) * * *

* * * * *

No amount shall be required to be deducted and withheld under chapter 24 with respect to any amount treated as compensation under this subsection.

* * * * *

Subchapter E—Accounting Period and Methods of Accounting

* * * * *

PART I—ACCOUNTING PERIODS

* * * * *

SEC. 443. RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS.

(a) * * *

* * * * *

(e) CROSS REFERENCES.—

For inapplicability of subsection (b) in computing—

(1) * * *

* * * * *

[(3) Undistributed foreign personal holding company income, see section 557.]

[(4)] (3) The taxable income of a regulated investment company, see section 852(b)(2)(E).

[(5)] (4) The taxable income of a real estate investment trust, see section 857(b)(2)(C).

* * * * *

PART II—METHODS OF ACCOUNTING IN GENERAL

* * * * *

Subpart B—Taxable Year for Which Items of Gross Income Included

* * * * *

SEC. 451. GENERAL RULE FOR TAXABLE YEAR OF INCLUSION.

(a) * * *

* * * * *

(e) SPECIAL RULE FOR PROCEEDS FROM LIVESTOCK SOLD ON ACCOUNT OF DROUGHT, FLOOD, OR OTHER WEATHER-RELATED CONDITIONS.—

(1) * * *

* * * * *

(3) SPECIAL ELECTION RULES.—If section 1033(e)(2) applies to a sale or exchange of livestock described in paragraph (1), the election under paragraph (1) shall be deemed valid if made during the replacement period described in such section.

* * * * *

Subpart C—Taxable Year for Which Deductions Taken

* * * * *

SEC. 461. GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

(a) * * *

* * * * *

(i) SPECIAL RULES FOR TAX SHELTERS.—

(1) * * *

* * * * *

(3) TAX SHELTER DEFINED.—For purposes of this subsection, the term “tax shelter” means—

(A) * * *

* * * * *

(C) any tax shelter (as defined in [section 6662(d)(2)(C)(iii)] *section 6662(d)(2)(C)(ii)*).

* * * * *

SEC. 465. DEDUCTIONS LIMITED TO AMOUNT AT RISK.

(a) * * *

* * * * *

(c) ACTIVITIES TO WHICH SECTION APPLIES.—

(1) * * *

* * * * *

(7) EXCLUSION OF ACTIVE BUSINESSES OF QUALIFIED C CORPORATIONS.—

(A) * * *

(B) QUALIFIED C CORPORATION.—For purposes of subparagraph (A), the term “qualified C corporation” means any corporation described in subparagraph (B) of subsection (a)(1) which is not—

(i) a personal holding company (as defined in section 542(a)), or

[(ii) a foreign personal holding company (as defined in section 552(a)), or]

[(iii) (ii) a personal service corporation (as defined in section 269A(b) but determined by substituting ‘5 percent’ for ‘10 percent’ in section 269A(b)(2)).]

* * * * *

SEC. 468B. SPECIAL RULES FOR DESIGNATED SETTLEMENT FUNDS.

(a) * * *

* * * * *

[(g) CLARIFICATION OF TAXATION OF CERTAIN FUNDS.—Nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.]

(g) CLARIFICATION OF TAXATION OF CERTAIN FUNDS.—

(1) *IN GENERAL.*—Except as provided in paragraph (2), nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

(2) *EXEMPTION FROM TAX FOR CERTAIN SETTLEMENT FUNDS.*—An escrow account, settlement fund, or similar fund shall be treated as beneficially owned by the United States and shall be exempt from taxation under this subtitle if—

(A) it is established pursuant to a consent decree entered by a judge of a United States District Court,

(B) it is created for the receipt of settlement payments as directed by a government entity for the sole purpose of resolving or satisfying one or more claims asserting liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980,

(C) the authority and control over the expenditure of funds therein (including the expenditure of contributions thereto and any net earnings thereon) is with such government entity, and

(D) upon termination, any remaining funds will be disbursed upon instructions by such government entity in accordance with applicable law.

For purposes of this paragraph, the term “government entity” means the United States, any State or political subdivision thereof, the District of Columbia, any possession of the United States, and any agency or instrumentality of any of the foregoing.

* * * * *

SEC. 469. PASSIVE ACTIVITY LOSSES AND CREDITS LIMITED.

(a) * * *

* * * * *

(k) **SEPARATE APPLICATION OF SECTION IN CASE OF PUBLICLY TRADED PARTNERSHIPS.**—

(1) * * *

* * * * *

(4) *APPLICATION TO REGULATED INVESTMENT COMPANIES.*—For purposes of this section, a regulated investment company (as defined in section 851) holding an interest in a qualified publicly traded partnership (as defined in section 851(h)) shall be treated as a taxpayer described in subsection (a)(2) with respect to items attributable to such interest.

* * * * *

Subchapter F—Exempt Organizations

* * * * *

PART I—GENERAL RULE

* * * * *

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

(a) * * *

* * * * *

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

(1) * * *

* * * * *

(15) [(A) Insurance companies or associations other than life (including interinsurers and reciprocal underwriters) if the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed \$350,000.]

(A) *Insurance companies (as defined in section 816(a)) other than life (including interinsurers and reciprocal underwriters) if—*

(i) the gross receipts for the taxable year do not exceed \$600,000, and

(ii) more than 50 percent of such gross receipts consist of premiums.

* * * * *

(C) For purposes of subparagraph (B), the term “controlled group” has the meaning given such term by section 831(b)(2)(B)(ii), *except that in applying section 1563 for purposes of section 831(b)(2)(B)(ii), subparagraphs (B) and (C) of section 1563(b)(2) shall be disregarded.*

* * * * *

PART II—PRIVATE FOUNDATIONS

* * * * *

SEC. 508. SPECIAL RULES WITH RESPECT TO SECTION 501(c)(3) ORGANIZATIONS.

(a) * * *

* * * * *

(d) DISALLOWANCE OF CERTAIN CHARITABLE, ETC., DEDUCTIONS.—

(1) GIFT OR BEQUEST TO ORGANIZATIONS SUBJECT TO SECTION 507(C) TAX.—No gift or bequest made to an organization upon which the tax provided by section 507(c) has been imposed shall be allowed as a deduction under section 170, 545(b)(2), [556(b)(2),] 642(c), 2055, 2106(a)(2), or 2522, if such gift or bequest is made—

(A) * * *

* * * * *

(2) GIFT OR BEQUEST TO TAXABLE PRIVATE FOUNDATION, SECTION 4947 TRUST, ETC.—No gift or bequest made to an organization shall be allowed as a deduction under section 170, 545(b)(2), [556(b)(2),] 642(c), 2055, 2106(a)(2), or 2522, if such gift or bequest is made—

(A) * * *

* * * * *

**PART III—TAXATION OF BUSINESS INCOME OF CERTAIN
EXEMPT ORGANIZATIONS**

* * * * *

SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.

(a) * * *

* * * * *

(e) SPECIAL RULES APPLICABLE TO S CORPORATIONS.—

(1) IN GENERAL.—If an organization described in section 1361(c)(2)(A)(vi) or 1361(c)(6) holds stock in an S corporation—

(A) * * *

* * * * *

**Subchapter G—Corporations Used to Avoid
Income Tax on Shareholders**

Part I. Corporations Improperly accumulating surplus.

* * * * *

[Part III. Foreign personal holding companies.]

* * * * *

**PART I—CORPORATIONS IMPROPERLY ACCUMULATING
SURPLUS**

* * * * *

SEC. 535. ACCUMULATED TAXABLE INCOME.

(a) * * *

* * * * *

(d) INCOME DISTRIBUTED TO UNITED STATES-OWNED FOREIGN CORPORATION RETAINS UNITED STATES CONNECTION.—

(1) * * *

(2) UNITED STATES-OWNED FOREIGN CORPORATION.—The term “United States-owned foreign corporation” has the meaning given to such term by [section 904(g)(6)] *section 904(h)(6)*.

* * * * *

PART II—PERSONAL HOLDING COMPANIES

* * * * *

SEC. 542. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) * * *

* * * * *

(c) EXCEPTIONS.—The term “personal holding company” as defined in subsection (a) does not include—

(1) * * *

* * * * *

[(5) a foreign personal holding company as defined in section 552;]

(5) *a foreign corporation,*

* * * * *

[(7) a foreign corporation (other than a corporation which has income to which section 543(a)(7) applies for the taxable year), if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations;]

[(8)] (7) a small business investment company which is licensed by the Small Business Administration and operating under the Small Business Investment Act of 1958 (15 U.S.C. 661 and following) and which is actively engaged in the business of providing funds to small business concerns under that Act. This paragraph shall not apply if any shareholder of the small business investment company owns at any time during the taxable year directly or indirectly (including, in the case of an individual, ownership by the members of his family as defined in section 544(a)(2) a 5 per centum or more proprietary interest in a small business concern to which funds are provided by the investment company or 5 per centum or more in value of the outstanding stock of such concern; *and*

[(9)] (8) a corporation which is subject to the jurisdiction of the court in a title 11 or similar case (within the meaning of section 368(a)(3)(A)) unless a major purpose of instituting or continuing such case is the avoidance of the tax imposed by section 541[; and].

[(10) a passive foreign investment company (as defined in section 1297.)

* * * * *

SEC. 543. PERSONAL HOLDING COMPANY INCOME

(a) * * *

(b) DEFINITIONS.—For purposes of this part—

(1) * * *

(A) all gains from the sale or other disposition of capital assets, *and*

(B) all gains (other than those referred to in subparagraph (A)) from the sale or other disposition of property described in section 1231(b)[, and].

[(C) in the case of a foreign corporation all of the outstanding stock of which during the last half of the taxable year is owned by nonresident alien individuals (whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations), all items of income which would, but for this subparagraph, constitute personal holding company income under any paragraph of subsection (a) other than paragraph (7) thereof.]

* * * * *

[PART III—FOREIGN PERSONAL HOLDING COMPANIES

[Sec. 551. Foreign personal holding company income taxed to United States shareholders.

[Sec. 552. Definition of foreign personal holding company.

[Sec. 553. Foreign personal holding company income.

[Sec. 554. Stock ownership.

- Sec. 555. Gross income of foreign personal holding companies.
- Sec. 556. Undistributed foreign personal holding company income.
- Sec. 557. Income not placed on annual basis.
- Sec. 558. Returns of officers, directors, and shareholders of foreign personal holding companies.

[SEC. 551. FOREIGN PERSONAL HOLDING COMPANY INCOME TAXED TO UNITED STATES SHAREHOLDERS.

■(a) GENERAL RULE.—The undistributed foreign personal holding company income of a foreign personal holding company shall be included in the gross income of the citizens or residents of the United States, domestic corporations, domestic partnerships, and estates or trusts (other than foreign estates or trusts), who are shareholders in such foreign personal holding company (hereinafter called “United States shareholders”) in the manner and to the extent set forth in this part.

■(b) AMOUNT INCLUDED IN GROSS INCOME.—Each United States shareholder, who was a shareholder on the day in the taxable year of the company which was the last day on which a United States group (as defined in section 552(a)(2)) existed with respect to the company, shall include in his gross income, as a dividend, for the taxable year in which or with which the taxable year of the company ends, the amount he would have received as a dividend (determined as if any distribution in liquidation actually made in such taxable year had not been made) if on such last day there had been distributed by the company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the company for the taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

■(c) INFORMATION IN RETURN.—Every United States shareholder who is required under subsection (b) to include in his gross income any amount with respect to the undistributed foreign personal holding company income of a foreign personal holding company and who, on the last day on which a United States group existed with respect to the company, owned 5 percent or more in value of the outstanding stock of such company, shall set forth in his return in complete detail the gross income, deductions and credits, taxable income, foreign personal holding company income, and undistributed foreign personal holding company income of such company.

■(d) EFFECT ON CAPITAL ACCOUNT OF FOREIGN PERSONAL HOLDING COMPANY.—An amount which bears the same ratio to the undistributed foreign personal holding company income of the foreign personal holding company for its taxable year as the portion of such taxable year up to and including the last day on which a United States group existed with respect to the company bears to the entire taxable year, shall, for the purpose of determining the effect of distributions in subsequent taxable years by the corporation, be considered as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of the taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend, directly or indirectly, in the gross income of United States shareholders.

[(e) BASIS OF STOCK IN HANDS OF SHAREHOLDERS.—The amount required to be included in the gross income of a United States shareholder under subsection (b) shall, for the purpose of adjusting the basis of his stock with respect to which the distribution would have been made (if it had been made), be treated as having been reinvested by the shareholder as a contribution to the capital of the corporation; but only to the extent to which such amount is included in his gross income in his return, increased or decreased by any adjustment of such amount in the last determination of the shareholder's tax liability, made before the expiration of 6 years after the date prescribed by law for filing the return.

[(f) STOCK HELD THROUGH FOREIGN ENTITY.—For purposes of this section, stock of a foreign personal holding company owned (directly or through the application of this subsection) by—

[(1) a foreign partnership or an estate or trust which is a foreign estate or trust, or

[(2) a foreign corporation which is not a foreign personal holding company, shall be considered as being owned proportionately by its partners, beneficiaries, or shareholders. In any case to which the preceding sentence applies, the Secretary may by regulations provide that rules similar to the rules of section 1298(b)(5) shall apply, and provide for such other adjustments in the application of this subchapter as may be necessary to carry out the purposes of this subsection.

[(g) COORDINATION WITH PASSIVE FOREIGN INVESTMENT COMPANY PROVISIONS.—If, but for this subsection, an amount would be included in the gross income of any person under subsection (a) and under section 1293 (relating to current taxation of income from certain passive foreign investment companies), such amount shall be included in the gross income of such person only under subsection (a).

[(h) CROSS REFERENCES.—

[(1) For basis of stock or securities in a foreign personal holding company acquired from a decedent, see section 1014(b)(5).

[(2) For period of limitation on assessment and collection without assessment, in case of failure to include in gross income the amount properly includible therein under subsection (b), see section 6501.

[SEC. 552. DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY.

[(a) GENERAL RULE.—For purposes of this subtitle, the term “foreign personal holding company” means any foreign corporation if—

[(1) GROSS INCOME REQUIREMENT.—At least 60 percent of its gross income (as defined in section 555(a)) for the taxable year is foreign personal holding company income as defined in section 553; but if the corporation is a foreign personal holding company with respect to any taxable year ending after August 26, 1937, then, for each subsequent taxable year, the minimum percentage shall be 50 percent in lieu of 60 percent, until a taxable year during the whole of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 50 percent of the gross income is foreign personal holding company income. For purposes of this paragraph, there shall be in-

cluded in the gross income the amount includible therein as a dividend by reason of the application of section 555(c)(2); and

[(2) STOCK OWNERSHIP REQUIREMENT.—At any time during the taxable year more than 50 percent of—

[(A) the total combined voting power of all classes of stock of such corporation entitled to vote, or

[(B) the total value of the stock of such corporation, is owned (directly or indirectly) by or for not more than 5 individuals who are citizens or residents of the United States (hereinafter in this part referred to as the “United States group”).

[(b) EXCEPTIONS.—The term “foreign personal holding company” does not include—

[(1) a corporation exempt from tax under subchapter F (sec. 501 and following); and

[(2) a corporation organized and doing business under the banking and credit laws of a foreign country if it is established (annually or at other periodic intervals) to the satisfaction of the Secretary that such corporation is not formed or availed of for the purpose of evading or avoiding United States income taxes which would otherwise be imposed upon its shareholders. If the Secretary is satisfied that such corporation is not so formed or availed of, he shall issue to such corporation annually or at other periodic intervals a certification that the corporation is not a foreign personal holding company.

Each United States shareholder of a foreign corporation which would, except for the provisions of paragraph (2), be a foreign personal holding company, shall attach to and file with his income tax return for the taxable year a copy of the certification by the Secretary made pursuant to paragraph (2). Such copy shall be filed with the taxpayer’s return for the taxable year if he has been a shareholder of such corporation for any part of such year.

[(c) LOOK-THRU FOR CERTAIN DIVIDENDS AND INTEREST.—

[(1) IN GENERAL.—For purposes of this part, any related person dividend or interest shall be treated as foreign personal holding company income only to the extent such dividend or interest is attributable (determined under rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which would be foreign personal holding company income.

[(2) RELATED PERSON DIVIDEND OR INTEREST.—For purposes of paragraph (1), the term “related person dividend or interest” means any dividend or interest which—

[(A) is described in subparagraph (A) of section 954(c)(3), and

[(B) is received from a related person which is not a foreign personal holding company (determined without regard to this subsection).

For purposes of the preceding sentence, the term “related person” has the meaning given such term by section 954(d)(3) (determined by substituting “foreign personal holding company” for “controlled foreign corporation” each place it appears).

[SEC. 553. FOREIGN PERSONAL HOLDING COMPANY INCOME.

[(a) FOREIGN PERSONAL HOLDING COMPANY INCOME.—For purposes of this subtitle, the term “foreign personal holding company income” means that portion of the gross income, determined for purposes of section 552, which consists of:

[(1) DIVIDENDS, ETC.—Dividends, interest, royalties, and annuities. This paragraph shall not apply to active business computer software royalties (as defined in section 543(d)).

[(2) STOCK AND SECURITIES TRANSACTIONS.—Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

[(3) COMMODITIES TRANSACTIONS.—Gains from futures transactions in any commodity on or subject to the rules of a board of trade or commodity exchange. This paragraph shall not apply to gains by a producer, processor, merchant, or handler of the commodity which arise out of bona fide hedging transactions reasonably necessary to the conduct of its business in the manner in which such business is customarily and usually conducted by others.

[(4) ESTATES AND TRUSTS.—Amounts includible in computing the taxable income of the corporation under part I of subchapter J (sec. 641 and following, relating to estates, trusts, and beneficiaries); and gains from the sale or other disposition of any interest in an estate or trust.

[(5) PERSONAL SERVICE CONTRACTS.—

[(A) Amounts received under a contract under which the corporation is to furnish personal services; if some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or if the individual who is to perform the services is designated (by name or by description) in the contract; and

[(B) amounts received from the sale or other disposition of such a contract.

This paragraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

[(6) USE OF CORPORATION PROPERTY BY SHAREHOLDER.—Amounts received as compensation (however designated and from whomsoever received) for the use of, or right to use, property of the corporation in any case where, at any time during the taxable year, 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for an individual entitled to the use of the property; whether such right is obtained directly from the corporation or by means of a sublease or other arrangement. This paragraph shall apply only to a corporation which has foreign personal holding company income for the taxable year, computed without regard to this paragraph and paragraph (7), in excess of 10 percent of its gross income.

[(7) RENTS.—Rents, unless constituting 50 percent or more of the gross income. For purposes of this paragraph, the term “rents” means compensation, however designated, for the use of, or right to use, property, but does not include amounts constituting foreign personal holding company income under paragraph (6).

[(b) LIMITATION ON GROSS INCOME IN CERTAIN TRANSACTIONS.—For purposes of this part—

[(1) gross income and foreign personal holding company income determined with respect to transactions described in subsection (a)(2) (relating to gains from stock and security transactions) shall include only the excess of gains over losses from such transactions, and

[(2) gross income and foreign personal holding company income determined with respect to transactions described in subsection (a)(3) (relating to gains from commodity transactions) shall include only the excess of gains over losses from such transactions.

[SEC. 554. STOCK OWNERSHIP.

[(a) CONSTRUCTIVE OWNERSHIP.—For purposes of determining whether a corporation is a foreign personal holding company, insofar as such determination is based on stock ownership under section 552(a)(2), section 553(a)(5), or section 553(a)(6)—

[(1) STOCK NOT OWNED BY INDIVIDUAL.—Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

[(2) FAMILY AND PARTNERSHIP OWNERSHIP.—An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For purposes of this paragraph, the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

[(3) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

[(4) APPLICATION OF FAMILY-PARTNERSHIP AND OPTION RULES.—Paragraphs (2) and (3) shall be applied—

[(A) for purposes of the stock ownership requirement provided in section 552(a)(2), if, but only if, the effect is to make the corporation a foreign personal holding company;

[(B) for purposes of section 553(a)(5) (relating to personal service contracts) or of section 553(a)(6) (relating to the use of property by shareholders), if, but only if, the effect is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income.

[(5) CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—Stock constructively owned by a person by reason of the application of paragraph (1) or (3) shall, for purposes of applying paragraph (1) or (2), be treated as actually owned by such person; but stock constructively owned by an individual by reason

of the application of paragraph (2) shall not be treated as owned by him for purposes of again applying such paragraph in order to make another the constructive owner of such stock.

[(6) OPTION RULE IN LIEU OF FAMILY AND PARTNERSHIP RULE.—If stock may be considered as owned by an individual under either paragraph (2) or (3) it shall be considered as owned by him under paragraph (3).

[(b) CONVERTIBLE SECURITIES.—Outstanding securities convertible into stock (whether or not convertible during the taxable year) shall be considered as outstanding stock—

[(1) for purposes of the stock ownership requirement provided in section 552(a)(2), but only if the effect of the inclusion of all such securities is to make the corporation a foreign personal holding company;

[(2) for purposes of section 553(a)(5) (relating to personal service contracts), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income; and

[(3) for purposes of section 553(a)(6) (relating to the use of property by shareholders), but only if the effect of the inclusion of all such securities is to make the amounts therein referred to includible under such paragraph as foreign personal holding company income.

The requirement in paragraphs (1), (2), and (3) that all convertible securities must be included if any are to be included shall be subject to the exception that, where some of the outstanding securities are convertible only after a later date than in the case of others, the class having the earlier conversion date may be included although the others are not included, but no convertible securities shall be included unless all outstanding securities having a prior conversion date are also included.

[(c) SPECIAL RULES FOR APPLICATION OF SUBSECTION (A)(2).—For purposes of the stock ownership requirement provided in section 552(a)(2)—

[(1) stock owned by a nonresident alien individual (other than a foreign trust or foreign estate) shall not be considered by reason of so much of subsection (a)(2) as relates to attribution through family membership as owned by a citizen or by a resident alien individual who is not the spouse of the nonresident individual and who does not otherwise own stock in such corporation (determined after the application of subsection (a), other than attribution through family membership), and

[(2) stock of a corporation owned by any foreign person shall not be considered by reason of so much of subsection (a)(2) as relates to attribution through partners as owned by a citizen or resident of the United States who does not otherwise own stock in such corporation (determined after application of subsection (a) and paragraph (1), other than attribution through partners).

[SEC. 555. GROSS INCOME OF FOREIGN PERSONAL HOLDING COMPANIES.

[(a) GENERAL RULE.—For purposes of this part, the term “gross income” means, with respect to a foreign corporation, gross income computed (without regard to the provisions of subchapter N (sec. 861 and following)) as if the foreign corporation were a domestic corporation which is a personal holding company.

[(b) ADDITIONS TO GROSS INCOME.—In the case of a foreign personal holding company (whether or not a United States group, as defined in section 552(a)(2), existed with respect to such company on the last day of its taxable year) which was a shareholder in another foreign personal holding company on the day in the taxable year of the second company which was the last day on which a United States group existed with respect to the second company, there shall be included, as a dividend, in the gross income of the first company, for the taxable year in which or with which the taxable year of the second company ends, the amount the first company would have received as a dividend if on such last day there had been distributed by the second company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the second company for its taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

[(c) APPLICATION OF SUBSECTION (B).—The rule provided in subsection (b)—

[(1) shall be applied in the case of a foreign personal holding company for the purpose of determining its undistributed foreign personal holding company income which, or a part of which, is to be included in the gross income of its shareholders, whether United States shareholders or other foreign personal holding companies;

[(2) shall be applied in the case of every foreign corporation with respect to which a United States group exists on some day of its taxable year, for the purpose of determining whether such corporation meets the gross income requirements of section 552(a)(1).

[SEC. 556. UNDISTRIBUTED FOREIGN PERSONAL HOLDING COMPANY INCOME.

[(a) DEFINITION.—For purposes of this part, the term “undistributed foreign personal holding company income” means the taxable income of a foreign personal holding company adjusted in the manner provided in subsection (b), minus the dividends paid deduction (as defined in section 561).

[(b) ADJUSTMENTS TO TAXABLE INCOME.—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

[(1) TAXES.—There shall be allowed as a deduction Federal income and excess profits taxes and income, war profits, and excess-profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 275(a)(4)), accrued during the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law.

[(2) CHARITABLE CONTRIBUTIONS.—The deduction for charitable contributions provided under section 170 shall be allowed, but in computing such deduction the limitations in section 170(b)(1)(A), (B), and (D) shall apply, and section 170(b)(2) and (d)(1) shall not apply. For purposes of this paragraph, the term “contribution base” when used in section 170(b)(1) means the taxable income computed with the adjustments (other than the 10-percent limitation) provided in section 170(b)(2) and (d)(1) and without the deduction of the amounts disallowed under paragraphs (5) and (6) of this subsection or the inclusion in gross income of the amounts includible therein as dividends by reason of the application of the provisions of section 555(b) (relating to the inclusion in gross income of a foreign personal holding company of its distributive share of the undistributed foreign personal holding company income of another company in which it is a shareholder).

[(3) SPECIAL DEDUCTIONS DISALLOWED.—The special deductions for corporations provided in part VIII (except section 248) of subchapter B (section 241 and following, relating to the deduction for dividends received by corporations, etc.) shall not be allowed.

[(4) NET OPERATING LOSS.—The net operating loss deduction provided in section 172 shall not be allowed, but there shall be allowed as a deduction the amount of the net operating loss (as defined in section 172(c)) for the preceding taxable year computed without the deductions provided in part VIII (except section 248) of subchapter B.

[(5) EXPENSES AND DEPRECIATION APPLICABLE TO PROPERTY OF THE TAXPAYER.—The aggregate of the deductions allowed under section 162 (relating to trade or business expenses) and section 167 (relating to depreciation) which are allocable to the operation and maintenance of property owned or operated by the company, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Secretary) to the satisfaction of the Secretary—

[(A) that the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

[(B) that the property was held in the course of a business carried on bona fide for profit; and

[(C) either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

[(6) TAXES AND CONTRIBUTIONS TO PENSION TRUSTS.—The deductions provided in section 164(e) (relating to taxes of a shareholder paid by the corporation) and in section 404 (relating to pension, etc., trusts) shall not be allowed.

[SEC. 557. INCOME NOT PLACED ON ANNUAL BASIS.

[Section 443(b) (relating to computation of tax on change of annual accounting period) shall not apply in the computation of the

undistributed foreign personal holding company income under section 556.

[SEC. 558. RETURNS OF OFFICERS, DIRECTORS, AND SHAREHOLDERS OF FOREIGN PERSONAL HOLDING COMPANIES.

[For provisions relating to returns of officers, directors, and shareholders of foreign personal holding companies, see section 6035.]

PART IV—DEDUCTION FOR DIVIDENDS PAID

* * * * *

SEC. 562. RULES APPLICABLE IN DETERMINING DIVIDENDS ELIGIBLE FOR DIVIDENDS PAID DEDUCTION.

(a) * * *

(b) DISTRIBUTIONS IN LIQUIDATION.—

(1) Except in the case of a personal holding company described in section 542 **[or a foreign personal holding company described in section 552]**—

(A) * * *

* * * * *

SEC. 563. RULES RELATING TO DIVIDENDS PAID AFTER CLOSE OF TAXABLE YEAR.

(a) * * *

* * * * *

[(c) FOREIGN PERSONAL HOLDING COMPANY TAX.—

[(1) IN GENERAL.—In the determination of the dividends paid deduction for purposes of part III, a dividend paid after the close of any taxable year and on or before the 15th day of the 3rd month following the close of such taxable year shall, to the extent the company designates such dividend as being taken into account under this subsection, be considered as paid during such taxable year. The amount allowed as a deduction by reason of the application of this subsection with respect to any taxable year shall not exceed the undistributed foreign personal holding company income of the corporation for the taxable year computed without regard to this subsection.

[(2) SPECIAL RULES.—In the case of any distribution referred to in paragraph (1)—

[(A) paragraph (1) shall apply only if such distribution is to the person who was the shareholder of record (as of the last day of the taxable year of the foreign personal holding company) with respect to the stock for which such distribution is made,

[(B) the determination of the person required to include such distribution in gross income shall be made under the principles of section 551(f), and

[(C) any person required to include such distribution in gross or distributable net income shall include such distribution in income for such person's taxable year in which the taxable year of the foreign personal holding company ends.]

[(d)] (c) DIVIDENDS CONSIDERED AS PAID ON LAST DAY OF TAXABLE YEAR.—For the purpose of applying section 562(a), with re-

spect to distributions under **subsection (a), (b) or (c)** *subsection (a) or (b)* of this section, a distribution made after the close of a taxable year and on or before the 15th day of the third month following the close of the taxable year shall be considered as made on the last day of such taxable year.

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Subchapter H—Banking Institutions

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PART I—RULES OF GENERAL APPLICATION TO BANKING INSTITUTIONS

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SEC. 582. BAD DEBTS, LOSSES, AND GAINS WITH RESPECT TO SECURITIES HELD BY FINANCIAL INSTITUTIONS.

(a) * * *

* * * * *

(c) BOND, ETC., LOSSES AND GAINS OF FINANCIAL INSTITUTIONS.—

(1) GENERAL RULE.—For purposes of this subtitle, in the case of a financial institution referred to in paragraph (2), the sale or exchange of a bond, debenture, note, or certificate or other evidence of indebtedness shall not be considered a sale or exchange of a capital asset. For purposes of the preceding sentence, any regular or residual interest in a REMIC¹, and any regular interest in a FASIT,² shall be treated as an evidence of indebtedness.

* * * * *

Subchapter I—Natural Resources

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PART III—SALES AND EXCHANGES

* * * * *

SEC. 631. GAIN OR LOSS IN THE CASE OF TIMBER, COAL, OR DOMESTIC IRON ORE.

(a) * * *

(b) DISPOSAL OF TIMBER **WITH A RETAINED ECONOMIC INTEREST**.—In the case of the disposal of timber held for more than 1 year before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner **retains an economic interest in such timber** *either retains an economic interest in such timber or makes an outright sale of such timber*, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber. In determining the gross income, the adjusted gross income, or the taxable income of the lessee, the deductions allowable with respect to rents and royalties shall be determined with-

out regard to the provisions of this subsection. **【The date of disposal】** *In the case of disposal of timber with a retained economic interest, the date of disposal of such timber shall be deemed to be the date such timber is cut, but if payment is made to the owner under the contract before such timber is cut the owner may elect to treat the date of such payment as the date of disposal of such timber. For purposes of this subsection, the term “owner” means any person who owns an interest in such timber, including a sublessor and a holder of a contract to cut timber.*

* * * * *

Subchapter K—Partners and Partnerships

* * * * *

PART I—DETERMINATION OF TAX LIABILITY

* * * * *

SEC. 704. PARTNER'S DISTRIBUTIVE SHARE.

(a) * * *

* * * * *

(c) CONTRIBUTED PROPERTY.—

(1) IN GENERAL.—Under regulations prescribed by the Secretary—

(A) income, gain, loss, and deduction with respect to property contributed to the partnership by a partner shall be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution, **【and】**

(B) if any property so contributed is distributed (directly or indirectly) by the partnership (other than to the contributing partner) within 7 years of being contributed—

(i) * * *

* * * * *

(iii) appropriate adjustments shall be made to the adjusted basis of the contributing partner's interest in the partnership and to the adjusted basis of the property distributed to reflect any gain or loss recognized under this subparagraph**【.】**, and

(C) if any property so contributed has a built-in loss—

(i) such built-in loss shall be taken into account only in determining the amount of items allocated to the contributing partner, and

(ii) except as provided in regulations, in determining the amount of items allocated to other partners, the basis of the contributed property in the hands of the partnership shall be treated as being equal to its fair market value at the time of contribution.

For purposes of subparagraph (C), the term “built-in loss” means the excess of the adjusted basis of the property (deter-

mined without regard to subparagraph (C)(ii)) over its fair market value at the time of contribution.

* * * * *

PART II—CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS

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Subpart B—Distributions by a Partnership

Sec. 731. Extent of recognition of gain or loss on distribution.

* * * * *

[Sec. 734. Optional adjustment to basis of undistributed partnership property.]

Sec. 734. Adjustment to basis of undistributed partnership property where section 754 election or substantial basis reduction.

* * * * *

[SEC. 734. OPTIONAL ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY.]

SEC. 734. ADJUSTMENT TO BASIS OF UNDISTRIBUTED PARTNERSHIP PROPERTY WHERE SECTION 754 ELECTION OR SUBSTANTIAL BASIS REDUCTION.

(a) **GENERAL RULE.**—The basis of partnership property shall not be adjusted as the result of a distribution of property to a partner unless the election, provided in section 754 (relating to optional adjustment to basis of partnership property), is in effect with respect to such partnership *or unless there is a substantial basis reduction.*

(b) **METHOD OF ADJUSTMENT.**—In the case of a distribution of property to a partner, a partnership, with respect to which the election provided in section 754 is in effect *or unless there is a substantial basis reduction*, shall—

(1) * * *

* * * * *

(d) **SUBSTANTIAL BASIS REDUCTION.**—

(1) **IN GENERAL.**—*For purposes of this section, there is a substantial basis reduction with respect to a distribution if the sum of the amounts described in subparagraphs (A) and (B) of subsection (b)(2) exceeds \$250,000.*

(2) **REGULATIONS.**—

For regulations to carry out this subsection, see section 743(d)(2).

* * * * *

Subpart C—Transfers of Interests in a Partnership

Sec. 741. Recognition and character of gain or loss on sale or exchange.

* * * * *

[Sec. 743. Optional adjustment to basis of partnership property.]

Sec. 743. Adjustment to basis of partnership property where section 754 election or substantial built-in loss.

* * * * *

[SEC. 743. OPTIONAL ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY.]**SEC. 743. ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY WHERE SECTION 754 ELECTION OR SUBSTANTIAL BUILT-IN LOSS.**

(a) **GENERAL RULE.**—The basis of partnership property shall not be adjusted as the result of a transfer of an interest in a partnership by sale or exchange or on the death of a partner unless the election provided by section 754 (relating to optional adjustment to basis of partnership property) is in effect with respect to such partnership *or unless the partnership has a substantial built-in loss immediately after such transfer.*

(b) **ADJUSTMENT TO BASIS OF PARTNERSHIP PROPERTY.**—In the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which the election provided in section 754 is in effect *or with respect to which there is a substantial built-in loss immediately after such transfer* shall—

(1) * * *

* * * * *

(d) **SUBSTANTIAL BUILT-IN LOSS.**—

(1) **IN GENERAL.**—*For purposes of this section, a partnership has a substantial built-in loss with respect to a transfer of an interest in a partnership if the partnership's adjusted basis in the partnership property exceeds by more than \$250,000 the fair market value of such property.*

(2) **REGULATIONS.**—*The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of paragraph (1) and section 734(d), including regulations aggregating related partnerships and disregarding property acquired by the partnership in an attempt to avoid such purposes.*

* * * * *

Subpart D—Provisions Common to Other Subparts

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SEC. 751. UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

(a) * * *

* * * * *

(d) **INVENTORY ITEMS.**—For purposes of this subchapter, the term “inventory items” means—

(1) * * *

(2) any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in section 1231, *and*

[(3) any other property of the partnership which, if sold or exchanged by the partnership, would result in a gain taxable under subsection (a) of section 1246 (relating to gain on foreign investment company stock), and]

[(4)] (3) any other property held by the partnership which, if held by the selling or distributee partner, would be consid-

ered property of the type described in [paragraph (1), (2), or (3)] *paragraph (1) or (2).*

* * * * *

SEC. 755. RULES FOR ALLOCATION OF BASIS.

(a) * * *

* * * * *

(c) *NO ALLOCATION OF BASIS DECREASE TO STOCK OF CORPORATE PARTNER.*—*In making an allocation under subsection (a) of any decrease in the adjusted basis of partnership property under section 734(b)—*

(1) no allocation may be made to stock in a corporation (or any person related (within the meaning of sections 267(b) and 707(b)(1)) to such corporation) which is a partner in the partnership, and

(2) any amount not allocable to stock by reason of paragraph (1) shall be allocated under subsection (a) to other partnership property.

Gain shall be recognized to the partnership to the extent that the amount required to be allocated under paragraph (2) to other partnership property exceeds the aggregate adjusted basis of such other property immediately before the allocation required by paragraph (2).

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Subchapter L—Insurance Companies

* * * * *

PART II—OTHER INSURANCE COMPANIES

* * * * *

SEC. 831. TAX ON INSURANCE COMPANIES OTHER THAN LIFE INSURANCE COMPANIES.

(a) * * *

(b) **ALTERNATIVE TAX FOR CERTAIN SMALL COMPANIES.**—

(1) * * *

(2) **COMPANIES TO WHICH THIS SUBSECTION APPLIES.**—

(A) **IN GENERAL.**—This subsection shall apply to every insurance company other than life (including interinsurers and reciprocal underwriters) if—

(i) the net written premiums (or, if greater, direct written premiums) for the taxable year [exceed \$350,000 but] do not exceed [\$1,200,000] \$1,890,000, and

* * * * *

(C) **INFLATION ADJUSTMENT.**—*In the case of any taxable year beginning in a calendar year after 2004, the \$1,890,000 amount in subparagraph (A) shall be increased by an amount equal to—*

(i) \$1,890,000, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting

“calendar year 2003” for “calendar year 1992” in subparagraph (B) thereof.
If the amount as adjusted under the preceding sentence is not a multiple of \$1,000, such amount shall be rounded to the next lowest multiple of \$1,000.

* * * * *

(c) *INSURANCE COMPANY DEFINED.*—For purposes of this section, the term “insurance company” has the meaning given to such term by section 816(a).

[(c)] (d) CROSS REFERENCES.—
 (1) * * *

* * * * *

PART III—PROVISIONS OF GENERAL APPLICATION

* * * * *

SEC. 845. CERTAIN REINSURANCE AGREEMENTS.

(a) ALLOCATION IN CASE OF REINSURANCE AGREEMENT INVOLVING TAX AVOIDANCE OR EVASION.—In the case of 2 or more related persons (within the meaning of section 482) who are parties to a reinsurance agreement (or where one of the parties to a reinsurance agreement is, with respect to any contract covered by the agreement, in effect an agent of another party to such agreement or a conduit between related persons), the Secretary may—

(1) * * *

* * * * *

if he determines that such allocation, recharacterization, or adjustment is necessary to reflect the proper [source and character] amount, source, or character of the taxable income (or any item described in paragraph (1) relating to such taxable income) of each such person.

* * * * *

Subchapter M—Regulated Investment Companies and Real Estate Investment Trusts

Part I. Regulated investment companies.

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[Part V. Financial asset securitization investment trusts.]

* * * * *

PART I—REGULATED INVESTMENT COMPANIES

* * * * *

SEC. 851. DEFINITION OF REGULATED INVESTMENT COMPANY.

(a) * * *

(b) LIMITATIONS.—A corporation shall not be considered a regulated investment company for any taxable year unless—

(1) * * *

[(2) at least 90 percent of its gross income is derived from dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or

other disposition of stock or securities (as defined in section 2(a)(36) of the Investment Company Act of 1940, as amended) or foreign currencies, or other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies; and

(2) *at least 90 percent of its gross income is derived from—*

(A) *dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the Investment Company Act of 1940, as amended) or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies, and*

(B) *distributions or other income derived from an interest in a qualified publicly traded partnership (as defined in subsection (h)); and*

(3) *at the close of each quarter of the taxable year—*

(A) * * *

[(B) not more than 25 percent of the value of its total assets is invested in the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer, or of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Secretary, to be engaged in the same or similar trades or businesses or related trades or businesses.]

(B) *not more than 25 percent of the value of its total assets is invested in—*

(i) *the securities (other than Government securities or the securities of other regulated investment companies) of any one issuer,*

(ii) *the securities (other than the securities of other regulated investment companies) of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Secretary, to be engaged in the same or similar trades or businesses or related trades or businesses, or*

(iii) *the securities of one or more qualified publicly traded partnerships (as defined in subsection (h)).*

For purposes of paragraph (2), there shall be treated as dividends amounts included in gross income under section 951(a)(1)(A)(i) or 1293(a) for the taxable year to the extent that, under section 959(a)(1) or 1293(c) (as the case may be), there is a distribution out of the earnings and profits of the taxable year which are attributable to the amounts so included. For purposes of paragraph (2), the Secretary may by regulation exclude from qualifying income foreign currency gains which are not directly related to the company's principal business of investing in stock or securities (or options and futures with respect to stock or securities). For purposes of paragraph (2), amounts excludable from gross income under section 103(a) shall be treated as included in gross income. Income derived from a partnership *(other than a qualified publicly traded*

partnership as defined in subsection (h)) or trust shall be treated as described in paragraph (2) only to the extent such income is attributable to items of income of the partnership or trust (as the case may be) which would be described in paragraph (2) if realized by the regulated investment company in the same manner as realized by the partnership or trust.

(c) RULES APPLICABLE TO SUBSECTION (B)(3).—For purposes of subsection (b)(3) and this subsection—

(1) * * *

* * * * *

(5) *The term “outstanding voting securities of such issuer” shall include the equity securities of a qualified publicly traded partnership (as defined in subsection (h)).*

[(5)] (6) All other terms shall have the same meaning as when used in the Investment Company Act of 1940, as amended.

* * * * *

(h) **QUALIFIED PUBLICLY TRADED PARTNERSHIP.**—*For purposes of this section, the term “qualified publicly traded partnership” means a publicly traded partnership described in section 7704(b) other than a partnership which would satisfy the gross income requirements of section 7704(c)(2) if qualifying income included only income described in subsection (b)(2)(A).*

* * * * *

PART II—REAL ESTATE INVESTMENT TRUSTS

* * * * *

SEC. 856. DEFINITION OF REAL ESTATE INVESTMENT TRUST.

(a) * * *

* * * * *

(c) **LIMITATIONS.**—A corporation, trust, or association shall not be considered a real estate investment trust for any taxable year unless—

(1) * * *

* * * * *

(5) For purposes of this part—

(A) * * *

* * * * *

(E) A regular or residual interest in a REMIC shall be treated as a real estate asset, and any amount includible in gross income with respect to such an interest shall be treated as interest on an obligation secured by a mortgage on real property; except that, if less than 95 percent of the assets of such REMIC are real estate assets (determined as if the real estate investment trust held such assets), such real estate investment trust shall be treated as holding directly (and as receiving directly) its proportionate share of the assets and income of the REMIC. For purposes of determining whether any interest in a REMIC qualifies under the preceding sentence, any interest held

by such REMIC in another REMIC shall be treated as a real estate asset under principles similar to the principles of the preceding sentence, except that, if such REMIC's are part of a tiered structure, they shall be treated as one REMIC for purposes of this subparagraph. **【The principles of the preceding provisions of this subparagraph shall apply to regular interests in a FASIT.】**

* * * * *

【(G) TREATMENT OF CERTAIN HEDGING INSTRUMENTS.—
Except to the extent provided by regulations, any—

【(i) payment to a real estate investment trust under an interest rate swap or cap agreement, option, futures contract, forward rate agreement, or any similar financial instrument, entered into by the trust in a transaction to reduce the interest rate risks with respect to any indebtedness incurred or to be incurred by the trust to acquire or carry real estate assets, and

【(ii) gain from the sale or other disposition of any such investment,
shall be treated as income qualifying under paragraph (2).**】**

(G) TREATMENT OF CERTAIN HEDGING INSTRUMENTS.—
Except to the extent provided by regulations, any income of a real estate investment trust from a hedging transaction (as defined in clause (ii) or (iii) of section 1221(b)(2)(A)) which is clearly identified pursuant to section 1221(a)(7), including gain from the sale or disposition of such a transaction, shall not constitute gross income under paragraph (2) to the extent that the transaction hedges any indebtedness incurred or to be incurred by the trust to acquire or carry real estate assets.

* * * * *

【(7) STRAIGHT DEBT SAFE HARBOR IN APPLYING PARAGRAPH (4).—Securities of an issuer which are straight debt (as defined in section 1361(c)(5) without regard to subparagraph (B)(iii) thereof) shall not be taken into account in applying paragraph (4)(B)(iii)(III) if—

【(A) the issuer is an individual, or

【(B) the only securities of such issuer which are held by the trust or a taxable REIT subsidiary of the trust are straight debt (as so defined), or

【(C) the issuer is a partnership and the trust holds at least a 20 percent profits interest in the partnership.】

(d) RENTS FROM REAL PROPERTY DEFINED.—

(1) * * *

* * * * *

(8) SPECIAL RULE FOR TAXABLE REIT SUBSIDIARIES.—For purposes of this subsection, amounts paid to a real estate investment trust by a taxable REIT subsidiary of such trust shall not be excluded from rents from real property by reason of paragraph (2)(B) if the requirements of either of the following subparagraphs are met:

【(A) LIMITED RENTAL EXCEPTION.—The requirements of this subparagraph are met with respect to any property if at least 90 percent of the leased space of the property is rented to persons other than taxable REIT subsidiaries of such trust and other than persons described in section 856(d)(2)(B). The preceding sentence shall apply only to the extent that the amounts paid to the trust as rents from real property (as defined in paragraph (1) without regard to paragraph (2)(B)) from such property are substantially comparable to such rents made by the other tenants of the trust's property for comparable space.】

(A) *LIMITED RENTAL EXCEPTION.*—

(i) *IN GENERAL.*—*The requirements of this subparagraph are met with respect to any property if at least 90 percent of the leased space of the property is rented to persons other than taxable REIT subsidiaries of such trust and other than persons described in paragraph (2)(B).*

(ii) *RENTS MUST BE SUBSTANTIALLY COMPARABLE.*—*Clause (i) shall apply only to the extent that the amounts paid to the trust as rents from real property (as defined in paragraph (1) without regard to paragraph (2)(B)) from such property are substantially comparable to such rents paid by the other tenants of the trust's property for comparable space.*

(iii) *TIMES FOR TESTING RENT COMPARABILITY.*—*The substantial comparability requirement of clause (ii) shall be treated as met with respect to a lease to a taxable REIT subsidiary of the trust if such requirement is met under the terms of the lease—*

(I) at the time such lease is entered into,

(II) at the time of each extension of the lease, including a failure to exercise a right to terminate, and

(III) at the time of any modification of the lease between the trust and the taxable REIT subsidiary if the rent under such lease is effectively increased pursuant to such modification.

With respect to subclause (III), if the taxable REIT subsidiary of the trust is a controlled taxable REIT subsidiary of the trust, the term “rents from real property” shall not in any event include rent under such lease to the extent of the increase in such rent on account of such modification.

(iv) *CONTROLLED TAXABLE REIT SUBSIDIARY.*—*For purposes of clause (iii), the term “controlled taxable REIT subsidiary” means, with respect to any real estate investment trust, any taxable REIT subsidiary of such trust if such trust owns directly or indirectly—*

(I) stock possessing more than 50 percent of the total voting power of the outstanding stock of such subsidiary, or

(II) stock having a value of more than 50 percent of the total value of the outstanding stock of such subsidiary.

(v) CONTINUING QUALIFICATION BASED ON THIRD PARTY ACTIONS.—If the requirements of clause (i) are met at a time referred to in clause (iii), such requirements shall continue to be treated as met so long as there is no increase in the space leased to any taxable REIT subsidiary of such trust or to any person described in paragraph (2)(B).

(vi) CORRECTION PERIOD.—If there is an increase referred to in clause (v) during any calendar quarter with respect to any property, the requirements of clause (iii) shall be treated as met during the quarter and the succeeding quarter if such requirements are met at the close of such succeeding quarter.

* * * * *

(m) SAFE HARBOR IN APPLYING SUBSECTION (c)(4).—

(1) IN GENERAL.—In applying subclause (III) of subsection (c)(4)(B)(iii), except as otherwise determined by the Secretary in regulations, the following shall not be considered securities held by the trust:

(A) Straight debt securities of an issuer which meet the requirements of paragraph (2).

(B) Any loan to an individual or an estate.

(C) Any section 467 rental agreement (as defined in section 467(d)), other than with a person described in subsection (d)(2)(B).

(D) Any obligation to pay rents from real property (as defined in subsection (d)(1)).

(E) Any security issued by a State or any political subdivision thereof, the District of Columbia, a foreign government or any political subdivision thereof, or the Commonwealth of Puerto Rico, but only if the determination of any payment received or accrued under such security does not depend in whole or in part on the profits of any entity not described in this subparagraph or payments on any obligation issued by such an entity,

(F) Any security issued by a real estate investment trust.

(G) Any other arrangement as determined by the Secretary.

(2) SPECIAL RULES RELATING TO STRAIGHT DEBT SECURITIES.—

(A) IN GENERAL.—For purposes of paragraph (1)(A), securities meet the requirements of this paragraph if such securities are straight debt, as defined in section 1361(c)(5) (without regard to subparagraph (B)(iii) thereof).

(B) SPECIAL RULES RELATING TO CERTAIN CONTINGENCIES.—For purposes of subparagraph (A), any interest or principal shall not be treated as failing to satisfy section 1361(c)(5)(B)(i) solely by reason of the fact that the time of payment of such interest or principal is subject to a contingency, but only if—

(i) any such contingency does not have the effect of changing the effective yield to maturity, as determined under section 1272, other than a change in the annual yield to maturity which either—

(I) does not exceed the greater of $\frac{1}{4}$ of 1 percent or 5 percent of the annual yield to maturity, or

(II) results solely from a default or the exercise of a prepayment right by the issuer of the debt, or
(ii) neither the aggregate issue price nor the aggregate face amount of the issuer's debt instruments held by the trust exceeds \$1,000,000 and not more than 12 months of unaccrued interest can be required to be prepaid thereunder.

(C) SPECIAL RULES RELATING TO CORPORATE OR PARTNERSHIP ISSUERS.—In the case of an issuer which is a corporation or a partnership, securities that otherwise would be described in paragraph (1)(A) shall be considered not to be so described if the trust holding such securities and any of its controlled taxable REIT subsidiaries (as defined in subsection (d)(8)(A)(iv)) hold any securities of the issuer which—

(i) are not described in paragraph (1) (prior to the application of this subparagraph), and

(ii) have an aggregate value greater than 1 percent of the issuer's outstanding securities determined without regard to paragraph (3)(A)(i).

(3) LOOK-THROUGH RULE FOR PARTNERSHIP SECURITIES.—

(A) IN GENERAL.—For purposes of applying subclause (III) of subsection (c)(4)(B)(iii)—

(i) a trust's interest as a partner in a partnership (as defined in section 7701(a)(2)) shall not be considered a security, and

(ii) the trust shall be deemed to own its proportionate share of each of the assets of the partnership.

(B) DETERMINATION OF TRUST'S INTEREST IN PARTNERSHIP ASSETS.—For purposes of subparagraph (A), with respect to any taxable year beginning after the date of the enactment of this subparagraph—

(i) the trust's interest in the partnership assets shall be the trust's proportionate interest in any securities issued by the partnership (determined without regard to subparagraph (A)(i) and paragraph (4), but not including securities described in paragraph (1)), and

(ii) the value of any debt instrument shall be the adjusted issue price thereof, as defined in section 1272(a)(4).

(4) CERTAIN PARTNERSHIP DEBT INSTRUMENTS NOT TREATED AS A SECURITY.—For purposes of applying subclause (III) of subsection (c)(4)(B)(iii)—

(A) any debt instrument issued by a partnership and not described in paragraph (1) shall not be considered a security to the extent of the trust's interest as a partner in the partnership, and

(B) any debt instrument issued by a partnership and not described in paragraph (1) shall not be considered a security if at least 75 percent of the partnership's gross income (excluding gross income from prohibited transactions) is derived from sources referred to in subsection (c)(3).

(5) *SECRETARIAL GUIDANCE.*—The Secretary is authorized to provide guidance (including through the issuance of a written determination, as defined in section 6110(b)) that an arrangement shall not be considered a security held by the trust for purposes of applying subclause (III) of subsection (c)(4)(B)(iii) notwithstanding that such arrangement otherwise could be considered a security under subparagraph (F) of subsection (c)(5).

(n) *LIMITATION ON DEDUCTION FOR INTEREST ON CERTAIN INDEBTEDNESS OF TAXABLE REIT SUBSIDIARY.*—

(1) *LIMITATION.*—

(A) *IN GENERAL.*—If this subsection applies to any taxable REIT subsidiary for any taxable year, no deduction shall be allowed under this chapter for disqualified interest paid or accrued by such subsidiary during such taxable year. The amount disallowed under the preceding sentence shall not exceed the subsidiary's excess interest expense for the taxable year.

(B) *DISALLOWED AMOUNT CARRIED TO SUCCEEDING TAXABLE YEAR.*—Any amount disallowed under subparagraph (A) for any taxable year shall be treated as disqualified interest paid or accrued in the succeeding taxable year (and clause (ii) of paragraph (2)(A) shall not apply for purposes of applying this subsection to the amount so treated).

(2) *SUBSIDIARIES TO WHICH SUBSECTION APPLIES.*—

(A) *IN GENERAL.*—This subsection shall apply to any taxable REIT subsidiary for any taxable year if—

(i) such subsidiary has excess interest expense for such taxable year, and

(ii) the ratio of debt to equity of such subsidiary as of the close of such taxable year (or on any other day during the taxable year as the Secretary may by regulations prescribe) exceeds 1.5 to 1.

(B) *EXCESS INTEREST EXPENSE.*—

(i) *IN GENERAL.*—For purposes of this subsection, the term “excess interest expense” means the excess (if any) of—

(I) the taxable REIT subsidiary's net interest expense, over

(II) the sum of 50 percent of the adjusted taxable income of the subsidiary plus any excess limitation carryforward under clause (ii).

(ii) *EXCESS LIMITATION CARRYFORWARD.*—If a taxable REIT subsidiary has an excess limitation for any taxable year, the amount of such excess limitation shall be an excess limitation carryforward to the 1st succeeding taxable year and to the 2nd and 3rd succeeding taxable years to the extent not previously taken into account under this clause. The amount of such a

carryforward taken into account for any such succeeding taxable year shall not exceed the excess interest expense for such succeeding taxable year (determined without regard to the carryforward from the taxable year of such excess limitation).

(iii) *EXCESS LIMITATION.*—For purposes of clause (ii), the term “excess limitation” means the excess (if any) of—

(I) 50 percent of the adjusted taxable income of the subsidiary, over

(II) the subsidiary’s net interest expense.

(C) *RATIO OF DEBT TO EQUITY.*—For purposes of this paragraph, the term “ratio of debt to equity” means the ratio which the total indebtedness of the subsidiary bears to the sum of its money and all other assets reduced (but not below zero) by such total indebtedness. The rules of section 163(j)(6)(E) shall apply for purposes of the preceding sentence.

(3) *DISQUALIFIED INTEREST.*—For purposes of this subsection, the term “disqualified interest” means any interest paid or accrued (directly or indirectly) by a taxable REIT subsidiary of a real estate investment trust to such trust.

(4) *OTHER RULES TO APPLY.*—Rules similar to the rules of paragraphs (7), (8), and (9) of section 163(j) shall apply for purposes of this subsection.

SEC. 857. TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES.

(a) * * *

(b) **METHOD OF TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND HOLDERS OF SHARES OR CERTIFICATES OF BENEFICIAL INTEREST.**—

(1) * * *

* * * * *

(5) **IMPOSITION OF TAX IN CASE OF FAILURE TO MEET CERTAIN REQUIREMENTS.**—If section 856(c)(6) applies to a real estate investment trust for any taxable year, there is hereby imposed on such trust a tax in an amount equal to the greater of—

(A) the excess of—

(i) **90 percent** 95 percent of the gross income (excluding gross income from prohibited transactions) of the real estate investment trust, over

* * * * *

(7) **INCOME FROM REDETERMINED RENTS, REDETERMINED DEDUCTIONS, AND EXCESS INTEREST.**—

(A) * * *

(B) **REDETERMINED RENTS.**—

(i) * * *

(ii) EXCEPTION FOR CERTAIN AMOUNTS.—Clause (i) shall not apply to amounts received directly or indirectly by a real estate investment trust—

[(I) for services furnished or rendered by a taxable REIT subsidiary that are described in paragraph (1)(B) of section 856(d), or

[(II) from a taxable REIT subsidiary that are described in paragraph (7)(C)(ii) of such section.]

[(iii)] (ii) EXCEPTION FOR DE MINIMIS AMOUNTS.—Clause (i) shall not apply to amounts described in section 856(d)(7)(A) with respect to a property to the extent such amounts do not exceed the one percent threshold described in section 856(d)(7)(B) with respect to such property.

[(iv)] (iii) EXCEPTION FOR COMPARABLY PRICED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

(I) * * *

* * * * *

[(v)] (iv) EXCEPTION FOR CERTAIN SEPARATELY CHARGED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

(I) * * *

* * * * *

[(vi)] (v) EXCEPTION FOR CERTAIN SERVICES BASED ON SUBSIDIARY'S INCOME FROM THE SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if the gross income of such subsidiary from such service is not less than 150 percent of such subsidiary's direct cost in furnishing or rendering the service.

[(vii)] (vi) EXCEPTIONS GRANTED BY SECRETARY.—The Secretary may waive the tax otherwise imposed by subparagraph (A) if the trust establishes to the satisfaction of the Secretary that rents charged to tenants were established on an arms' length basis even though a taxable REIT subsidiary of the trust provided services to such tenants.

* * * * *

PART IV—REAL ESTATE MORTGAGE INVESTMENT CONDUITS

* * * * *

SEC. 860G. OTHER DEFINITIONS AND SPECIAL RULES.

(a) DEFINITIONS.—For purposes of this part—

(1) REGULAR INTEREST.—The term “regular interest” means any interest in a REMIC which is issued on the startup day with fixed terms and which is designated as a regular interest if—

(A) * * *

* * * * *

The interest shall not fail to meet the requirements of subparagraph (A) merely because the timing (but not the amount) of the principal payments (or other similar amounts) may be contingent on the extent of prepayments on qualified mortgages and the amount of income from permitted investments. *An interest shall not fail to qualify as a regular interest solely because the specified principal amount of the regular interest (or the amount of interest accrued on the regular interest) can be reduced as a result of the nonoccurrence of 1 or more contingent payments with respect to any reverse mortgage loan held by the REMIC if, on the startup day for the REMIC, the sponsor reasonably believes that all principal and interest due under the regular interest will be paid at or prior to the liquidation of the REMIC.*

* * * * *

(3) QUALIFIED MORTGAGE.—The term “qualified mortgage” means—

(A) any obligation (including any participation or certificate of beneficial ownership therein) which is principally secured by an interest in real property and which—

(i) is transferred to the REMIC on the startup day in exchange for regular or residual interests in the REMIC, **[or]**

(ii) is purchased by the REMIC within the 3-month period beginning on the startup day if, except as provided in regulations, such purchase is pursuant to a fixed-price contract in effect on the startup day, *or*

(iii) *represents an increase in the principal amount under the original terms of an obligation described in clause (i) or (ii) if—*

(I) such increase in the balance is attributable to an advance made to the obligor pursuant to the original terms of the obligation,

(II) such increase in the balance occurs after the startup day, and

(III) such increase in the balance is purchased by the REMIC pursuant to a fixed price contract in effect on the startup day.

(B) any qualified replacement mortgage, *and*

(C) any regular interest in another REMIC transferred to the REMIC on the startup day in exchange for regular or residual interests in the REMIC **[, and].**

[(D) any regular interest in a FASIT which is transferred to, or purchased by, the REMIC as described in clauses (i) and (ii) of subparagraph (A) but only if 95 percent or more of the value of the assets of such FASIT is at all times attributable to obligations described in subparagraph (A) (without regard to such clauses).]

For purposes of subparagraph (A) any obligation secured by stock held by a person as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as so defined) shall be treated as secured by an interest in real property, *and any reverse mortgage loan (and each balance increase on such loan meeting the requirements of subparagraph (A)(iii)) shall be treated as an obligation secured by an interest in real property.* For purposes of subparagraph (A), if more than 50 percent of the obligations transferred to, or purchased by, the REMIC are originated by the United States or any State (or any political subdivision, agency, or instrumentality of the United States or any State) and are principally secured by an interest in real property, then each obligation transferred to, or purchased by, the REMIC shall be treated as secured by an interest in real property.

* * * * *

(7) QUALIFIED RESERVE ASSET.—

(A) * * *

[(B) QUALIFIED RESERVE FUND.—For purposes of subparagraph (A), the term ‘qualified reserve fund’ means any reasonably required reserve to provide for full payment of expenses of the REMIC or amounts due on regular interests in the event of defaults on qualified mortgages or lower than expected returns on cash flow investments. The amount of any such reserve shall be promptly and appropriately reduced as payments of qualified mortgages are received.]

(B) QUALIFIED RESERVE FUND.—For purposes of subparagraph (A), the term “qualified reserve fund” means any reasonably required reserve to—

(i) provide for full payment of expenses of the REMIC or amounts due on regular interests in the event of defaults on qualified mortgages or lower than expected returns on cash flow investments, or

(ii) provide a source of funds for the purchase of obligations described in clause (ii) or (iii) of paragraph (3)(A).

The aggregate fair market value of the assets held in any such reserve shall not exceed 50 percent of the aggregate fair market value of all of the assets of the REMIC on the startup day, and the amount of any such reserve shall be promptly and appropriately reduced to the extent the amount held in such reserve is no longer reasonably required for purposes specified in clause (i) or (ii) of paragraph (3)(A).

* * * * *

[PART V—FINANCIAL ASSET SECURITIZATION INVESTMENT TRUSTS

[Sec. 860H. Taxation of a fasit; other general rules.

[Sec. 860I. Gain recognition on contributions to a fasit and in other cases.

[Sec. 860J. Non-Fasit losses not to offset certain fasit inclusions.

【Sec. 860K. Treatment of transfers of high-yield interests to disqualified holders.

【Sec. 860L. Definitions and other special rules.

【SEC. 860H. TAXATION OF A FASIT; OTHER GENERAL RULES.

【(a) TAXATION OF FASIT.—A FASIT as such shall not be subject to taxation under this subtitle (and shall not be treated as a trust, partnership, corporation, or taxable mortgage pool).

【(b) TAXATION OF HOLDER OF THE OWNERSHIP INTEREST.—In determining the taxable income of the holder of the ownership interest in a FASIT—

【(1) all assets, liabilities, and items of income, gain, deduction, loss, and credit of a FASIT shall be treated as assets, liabilities, and such items (as the case may be) of such holder,

【(2) the constant yield method (including the rules of section 1272(a)(6)) shall be applied under an accrual method of accounting in determining all interest, acquisition discount, original issue discount, and market discount and all premium deductions or adjustments with respect to each debt instrument of the FASIT,

【(3) there shall not be taken into account any item of income, gain, or deduction allocable to a prohibited transaction, and

【(4) interest accrued by the FASIT which is exempt from tax imposed by this subtitle shall, when taken into account by such holder, be treated as ordinary income.

【(c) TREATMENT OF REGULAR INTERESTS.—For purposes of this title—

【(1) a regular interest in a FASIT, if not otherwise a debt instrument, shall be treated as a debt instrument,

【(2) section 163(e)(5) shall not apply to such an interest, and

【(3) amounts includible in gross income with respect to such an interest shall be determined under an accrual method of accounting.

【SEC. 860I. GAIN RECOGNITION ON CONTRIBUTIONS TO A FASIT AND IN OTHER CASES.

【(a) TREATMENT OF PROPERTY ACQUIRED BY FASIT.—

【(1) PROPERTY ACQUIRED FROM HOLDER OF OWNERSHIP INTEREST OR RELATED PERSON.—If property is sold or contributed to a FASIT by the holder of the ownership interest in such FASIT (or by a related person) gain (if any) shall be recognized to such holder (or person) in an amount equal to the excess (if any) of such property's value under subsection (d) on the date of such sale or contribution over its adjusted basis on such date.

【(2) PROPERTY ACQUIRED OTHER THAN FROM HOLDER OF THE OWNERSHIP INTEREST OR RELATED PERSON.—Property which is acquired by a FASIT other than in a transaction to which paragraph (1) applies shall be treated—

【(A) as having been acquired by the holder of the ownership interest in the FASIT for an amount equal to the FASIT's cost of acquiring such property, and

【(B) as having been sold by such holder to the FASIT at its value under subsection (d) on such date.

[(b) GAIN RECOGNITION ON PROPERTY OUTSIDE FASIT WHICH SUPPORTS REGULAR INTERESTS.—If property held by the holder of the ownership interest in a FASIT (or by any person related to such holder) supports any regular interest in such FASIT—

[(1) gain shall be recognized to such holder (or person) in the same manner as if such holder (or person) had sold such property at its value under subsection (d) on the earliest date such property supports such an interest, and

[(2) such property shall be treated as held by such FASIT for purposes of this part.

[(c) DEFERRAL OF GAIN RECOGNITION.—The Secretary may prescribe regulations which—

[(1) provide that gain otherwise recognized under subsection (a) or (b) shall not be recognized before the earliest date on which such property supports any regular interest in such FASIT or any indebtedness of the holder of the ownership interest (or of any person related to such holder), and

[(2) provide such adjustments to the other provisions of this part to the extent appropriate in the context of the treatment provided under paragraph (1).

[(d) VALUATION.—For purposes of this section—

[(1) IN GENERAL.—The value of any property under this subsection shall be—

[(A) in the case of a debt instrument which is not traded on an established securities market, the sum of the present values of the reasonably expected payments under such instrument determined (in the manner provided by regulations prescribed by the Secretary)—

[(i) as of the date of the event resulting in the gain recognition under this section, and

[(ii) by using a discount rate equal to 120 percent of the applicable Federal rate (as defined in section 1274(d)), or such other discount rate specified in such regulations, compounded semiannually, and

[(B) in the case of any other property, its fair market value.

[(2) SPECIAL RULE FOR REVOLVING LOAN ACCOUNTS.—For purposes of paragraph (1)—

[(A) each extension of credit (other than the accrual of interest) on a revolving loan account shall be treated as a separate debt instrument, and

[(B) payments on such extensions of credit having substantially the same terms shall be applied to such extensions beginning with the earliest such extension.

[(e) SPECIAL RULES.—

[(1) NONRECOGNITION RULES NOT TO APPLY.—Gain required to be recognized under this section shall be recognized notwithstanding any other provision of this subtitle.

[(2) BASIS ADJUSTMENTS.—The basis of any property on which gain is recognized under this section shall be increased by the amount of gain so recognized.

[SEC. 860J. NON-FASIT LOSSES NOT TO OFFSET CERTAIN FASIT INCLUSIONS.

[(a) IN GENERAL.—The taxable income of the holder of the ownership interest or any high-yield interest in a FASIT for any taxable year shall in no event be less than the sum of—

[(1) such holder's taxable income determined solely with respect to such interests (including gains and losses from sales and exchanges of such interests), and

[(2) the excess inclusion (if any) under section 860E(a)(1) for such taxable year.

[(b) COORDINATION WITH SECTION 172.—Any increase in the taxable income of any holder of the ownership interest or a high-yield interest in a FASIT for any taxable year by reason of subsection (a) shall be disregarded—

[(1) in determining under section 172 the amount of any net operating loss for such taxable year, and

[(2) in determining taxable income for such taxable year for purposes of the second sentence of section 172(b)(2).

[(c) COORDINATION WITH MINIMUM TAX.—For purposes of part VI of subchapter A of this chapter—

[(1) the reference in section 55(b)(2) to taxable income shall be treated as a reference to taxable income determined without regard to this section,

[(2) the alternative minimum taxable income of any holder of the ownership interest or a high-yield interest in a FASIT for any taxable year shall in no event be less than such holder's taxable income determined solely with respect to such interests, and

[(3) any increase in taxable income under this section shall be disregarded for purposes of computing the alternative tax net operating loss deduction.

[(d) AFFILIATED GROUPS.—All members of an affiliated group filing a consolidated return shall be treated as one taxpayer for purposes of this section.

[SEC. 860K. TREATMENT OF TRANSFERS OF HIGH-YIELD INTERESTS TO DISQUALIFIED HOLDERS.

[(a) GENERAL RULE.—In the case of any high-yield interest which is held by a disqualified holder—

[(1) the gross income of such holder shall not include any income (other than gain) attributable to such interest, and

[(2) amounts not includible in the gross income of such holder by reason of paragraph (1) shall be included (at the time otherwise includible under paragraph (1)) in the gross income of the most recent holder of such interest which is not a disqualified holder.

[(b) EXCEPTIONS.—Rules similar to the rules of paragraphs (4) and (7) of section 860E(e) shall apply to the tax imposed by reason of the inclusion in gross income under subsection (a).

[(c) DISQUALIFIED HOLDER.—For purposes of this section, the term “disqualified holder” means any holder other than—

[(1) an eligible corporation (as defined in section 860L(a)(2)), or

[(2) a FASIT.

[(d) TREATMENT OF INTERESTS HELD BY SECURITIES DEALERS.—

[(1) IN GENERAL.—Subsection (a) shall not apply to any high-yield interest held by a disqualified holder if such holder is a dealer in securities who acquired such interest exclusively for sale to customers in the ordinary course of business (and not for investment).

[(2) CHANGE IN DEALER STATUS.—

[(A) IN GENERAL.—In the case of a dealer in securities which is not an eligible corporation (as defined in section 860L(a)(2)), if—

[(i) such dealer ceases to be a dealer in securities,

or

[(ii) such dealer commences holding the high-yield interest for investment,

there is hereby imposed (in addition to other taxes) an excise tax equal to the product of the highest rate of tax specified in section 11(b)(1) and the income of such dealer attributable to such interest for periods after the date of such cessation or commencement.

[(B) HOLDING FOR 31 DAYS OR LESS.—For purposes of subparagraph (A)(ii), a dealer shall not be treated as holding an interest for investment before the thirty-second day after the date such dealer acquired such interest unless such interest is so held as part of a plan to avoid the purposes of this paragraph.

[(C) ADMINISTRATIVE PROVISIONS.—The deficiency procedures of subtitle F shall apply to the tax imposed by this paragraph.

[(e) TREATMENT OF HIGH-YIELD INTERESTS IN PASS-THRU ENTITIES.—

[(1) IN GENERAL.—If a pass-thru entity (as defined in section 860E(e)(6)) issues a debt or equity interest—

[(A) which is supported by any regular interest in a FASIT, and

[(B) which has an original yield to maturity which is greater than each of—

[(i) the sum determined under clauses (i) and (ii) of section 163(i)(1)(B) with respect to such debt or equity interest, and

[(ii) the yield to maturity to such entity on such regular interest (determined as of the date such entity acquired such interest),

there is hereby imposed on the pass-thru entity a tax (in addition to other taxes) equal to the product of the highest rate of tax specified in section 11(b)(1) and the income of the holder of such debt or equity interest which is properly attributable to such regular interest. For purposes of the preceding sentence, the yield to maturity of any equity interest shall be determined under regulations prescribed by the Secretary.

[(2) EXCEPTION.—Paragraph (1) shall not apply to arrangements not having as a principal purpose the avoidance of the purposes of this subsection.

[SEC. 860L. DEFINITIONS AND OTHER SPECIAL RULES.**[(a) FASIT.—**

[(1) IN GENERAL.—For purposes of this title, the terms “financial asset securitization investment trust” and “FASIT” mean any entity—

[(A) for which an election to be treated as a FASIT applies for the taxable year,

[(B) all of the interests in which are regular interests or the ownership interest,

[(C) which has only one ownership interest and such ownership interest is held directly by an eligible corporation,

[(D) as of the close of the third month beginning after the day of its formation and at all times thereafter, substantially all of the assets of which (including assets treated as held by the entity under section 860I(b)(2)) consist of permitted assets, and

[(E) which is not described in section 851(a).

A rule similar to the rule of the last sentence of section 860D(a) shall apply for purposes of this paragraph.

[(2) ELIGIBLE CORPORATION.—For purposes of paragraph (1)(C), the term “eligible corporation” means any domestic C corporation other than—

[(A) a corporation which is exempt from, or is not subject to, tax under this chapter,

[(B) an entity described in section 851(a) or 856(a),

[(C) a REMIC, and

[(D) an organization to which part I of subchapter T applies.

[(3) ELECTION.—An entity (otherwise meeting the requirements of paragraph (1)) may elect to be treated as a FASIT. Except as provided in paragraph (5), such an election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

[(4) TERMINATION.—If any entity ceases to be a FASIT at any time during the taxable year, such entity shall not be treated as a FASIT after the date of such cessation.

[(5) INADVERTENT TERMINATIONS, ETC.—Rules similar to the rules of section 860D(b)(2)(B) shall apply to inadvertent failures to qualify or remain qualified as a FASIT.

[(6) PERMITTED ASSETS NOT TREATED AS INTEREST IN FASIT.—Except as provided in regulations prescribed by the Secretary, any asset which is a permitted asset at the time acquired by a FASIT shall not be treated at any time as an interest in such FASIT.

[(b) INTERESTS IN FASIT.—For purposes of this part—**[(1) REGULAR INTEREST.—**

[(A) IN GENERAL.—The term “regular interest” means any interest which is issued by a FASIT on or after the startup date with fixed terms and which is designated as a regular interest if—

[(i) such interest unconditionally entitles the holder to receive a specified principal amount (or other similar amount),

[(ii) interest payments (or other similar amounts), if any, with respect to such interest are determined based on a fixed rate, or, except as otherwise provided by the Secretary, at a variable rate permitted under section 860G(a)(1)(B)(i),

[(iii) such interest does not have a stated maturity (including options to renew) greater than 30 years (or such longer period as may be permitted by regulations),

[(iv) the issue price of such interest does not exceed 125 percent of its stated principal amount, and

[(v) the yield to maturity on such interest is less than the sum determined under section 163(i)(1)(B) with respect to such interest.

An interest shall not fail to meet the requirements of clause (i) merely because the timing (but not the amount) of the principal payments (or other similar amounts) may be contingent on the extent that payments on debt instruments held by the FASIT are made in advance of anticipated payments and on the amount of income from permitted assets.

[(B) HIGH-YIELD INTERESTS.—

[(i) IN GENERAL.—The term “regular interest” includes any high-yield interest.

[(ii) HIGH-YIELD INTEREST.—The term “high-yield interest” means any interest which would be described in subparagraph (A) but for—

[(I) failing to meet the requirements of one or more of clauses (i), (iv), or (v) thereof, or

[(II) failing to meet the requirement of clause (ii) thereof but only if interest payments (or other similar amounts), if any, with respect to such interest consist of a specified portion of the interest payments on permitted assets and such portion does not vary during the period such interest is outstanding.

[(2) OWNERSHIP INTEREST.—The term “ownership interest” means the interest issued by a FASIT after the startup day which is designated as an ownership interest and which is not a regular interest.

[(c) PERMITTED ASSETS.—For purposes of this part—

[(1) IN GENERAL.—The term “permitted asset” means—

[(A) cash or cash equivalents,

[(B) any debt instrument (as defined in section 1275(a)(1)) under which interest payments (or other similar amounts), if any, at or before maturity meet the requirements applicable under clause (i) or (ii) of section 860G(a)(1)(B),

[(C) foreclosure property,

[(D) any asset—

[(i) which is an interest rate or foreign currency notional principal contract, letter of credit, insurance, guarantee against payment defaults, or other similar instrument permitted by the Secretary, and

[(ii) which is reasonably required to guarantee or hedge against the FASIT's risks associated with being the obligor on interests issued by the FASIT,

[(E) contract rights to acquire debt instruments described in subparagraph (B) or assets described in subparagraph (D),

[(F) any regular interest in another FASIT, and

[(G) any regular interest in a REMIC.

[(2) DEBT ISSUED BY HOLDER OF OWNERSHIP INTEREST NOT PERMITTED ASSET.—The term “permitted asset” shall not include any debt instrument issued by the holder of the ownership interest in the FASIT or by any person related to such holder or any direct or indirect interest in such a debt instrument. The preceding sentence shall not apply to cash equivalents and to any other investment specified in regulations prescribed by the Secretary.

[(3) FORECLOSURE PROPERTY.—

[(A) IN GENERAL.—The term “foreclosure property” means property—

[(i) which would be foreclosure property under section 856(e) (determined without regard to paragraph (5) thereof) if such property were real property acquired by a real estate investment trust, and

[(ii) which is acquired in connection with the default or imminent default of a debt instrument held by the FASIT unless the security interest in such property was created for the principal purpose of permitting the FASIT to invest in such property.

Solely for purposes of subsection (a)(1), the determination of whether any property is foreclosure property shall be made without regard to section 856(e)(4).

[(B) AUTHORITY TO REDUCE GRACE PERIOD.—In the case of property other than real property and other than personal property incident to real property, the Secretary may by regulation reduce for purposes of subparagraph (A) the periods otherwise applicable under paragraphs (2) and (3) of section 856(e).

[(d) STARTUP DAY.—For purposes of this part—

[(1) IN GENERAL.—The term “startup day” means the date designated in the election under subsection (a)(3) as the startup day of the FASIT. Such day shall be the beginning of the first taxable year of the FASIT.

[(2) TREATMENT OF PROPERTY HELD ON STARTUP DAY.—All property held (or treated as held under section 860I(b)(2)) by an entity as of the startup day shall be treated as contributed to such entity on such day by the holder of the ownership interest in such entity.

[(e) TAX ON PROHIBITED TRANSACTIONS.—

[(1) IN GENERAL.—There is hereby imposed for each taxable year of a FASIT a tax equal to 100 percent of the net income derived from prohibited transactions. Such tax shall be paid by the holder of the ownership interest in the FASIT.

[(2) PROHIBITED TRANSACTION.—For purposes of this part, the term “prohibited transaction” means—

[(A) except as provided in paragraph (3), the receipt of any income derived from any asset that is not a permitted asset,

[(B) except as provided in paragraph (3), the disposition of any permitted asset other than foreclosure property,

[(C) the receipt of any income derived from any loan originated by the FASIT, and

[(D) the receipt of any income representing a fee or other compensation for services (other than any fee received as compensation for a waiver, amendment, or consent under permitted assets (other than foreclosure property) held by the FASIT).

[(3) EXCEPTION FOR INCOME FROM CERTAIN DISPOSITIONS.—

[(A) IN GENERAL.—Paragraph (2)(B) shall not apply to a disposition which would not be a prohibited transaction (as defined in section 860F(a)(2)) by reason of—

[(i) clause (ii), (iii), or

[(iv) of section 860F(a)(2)(A), or

[(ii) section 860F(a)(5),

if the FASIT were treated as a REMIC and permitted assets (other than cash or cash equivalents) were treated as qualified mortgages.

[(B) SUBSTITUTION OF DEBT INSTRUMENTS; REDUCTION OF OVERCOLLATERIZATION.—Paragraph (2)(B) shall not apply to—

[(i) the substitution of a debt instrument described in subsection (c)(1)(B) for another debt instrument which is a permitted asset, or

[(ii) the distribution of a debt instrument contributed by the holder of the ownership interest to such holder in order to reduce over-collateralization of the FASIT, but only if a principal purpose of acquiring the debt instrument which is disposed of was not the recognition of gain (or the reduction of a loss) as a result of an increase in the market value of the debt instrument after its acquisition by the FASIT.

[(C) LIQUIDATION OF REGULAR INTERESTS.—Paragraph (2)(B) shall not apply to the complete liquidation of any class of regular interests.

[(D) INCOME FROM DISPOSITIONS OF FORMER HEDGE ASSETS.—Paragraph (2)(A) shall not apply to income derived from the disposition of—

[(i) an asset which was described in subsection (c)(1)(D) when first acquired by the FASIT but on the date of such disposition was no longer described in subsection (c)(1)(D)(ii), or

[(ii) a contract right to acquire an asset described in clause (i).

[(4) NET INCOME.—For purposes of this subsection, net income shall be determined in accordance with section 860F(a)(3).

[(f) COORDINATION WITH OTHER PROVISIONS.—

[(1) WASH SALES RULES.—Rules similar to the rules of section 860F(d) shall apply to the ownership interest in a FASIT.

[(2) SECTION 475.—Except as provided by the Secretary by regulations, if any security which is sold or contributed to a FASIT by the holder of the ownership interest in such FASIT was required to be marked-to-market under section 475 by such holder, section 475 shall continue to apply to such security; except that in applying section 475 while such security is held by the FASIT, the fair market value of such security for purposes of section 475 shall not be less than its value under section 860I(d).

[(g) RELATED PERSON.—For purposes of this part, a person (hereinafter in this subsection referred to as the “related person”) is related to any person if—

[(1) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1), or

[(2) the related person and such person are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52).

For purposes of paragraph (1), in applying section 267(b) or 707(b)(1), “20 percent” shall be substituted for “50 percent”.

[(h) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part, including regulations to prevent the abuse of the purposes of this part through transactions which are not primarily related to securitization of debt instruments by a FASIT.]

* * * * *

Subchapter N—Tax Based on Income From Sources Within or Without the United States

* * * * *

PART I—SOURCE RULES AND OTHER GENERAL RULES RELATING TO FOREIGN INCOME

* * * * *

SEC. 861. INCOME FROM SOURCES WITHIN THE UNITED STATES.

(a) GROSS INCOME FROM SOURCES WITHIN UNITED STATES.—The following items of gross income shall be treated as income from sources within the United States:

(1) * * *

(A) interest from a resident alien individual or domestic corporation, if such individual or corporation meets the 80-percent foreign business requirements of subsection (c)(1), [and]

(B) interest—

(i) * * *

(ii) on amounts satisfying the requirements of subparagraph (B) of section 871(i)(3) which are paid by a foreign branch of a domestic corporation or a domestic partnership[.], and

(C) in the case of a foreign partnership in which United States persons do not hold directly or indirectly 20 percent or more of either the capital or profits interests, any interest not paid by a trade or business engaged in by the partnership in the United States and not allocable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States.

* * * * *

SEC. 864. DEFINITIONS AND SPECIAL RULES.

(a) * * *

* * * * *

(d) TREATMENT OF RELATED PERSON FACTORING INCOME.—

(1) * * *

(2) PROVISIONS TO WHICH PARAGRAPH (1) APPLIES.—The provisions set forth in this paragraph are as follows:

[(A) Part III of subchapter G of this chapter (relating to foreign personal holding companies).]

[(B)] (A) Section 904 (relating to limitation on foreign tax credit).

[(C)] (B) Subpart F of part III of this subchapter (relating to controlled foreign corporations).

* * * * *

(5) CERTAIN PROVISIONS NOT TO APPLY.—

(A) CERTAIN EXCEPTIONS.—The following provisions shall not apply to any amount treated as interest under paragraph (1) or (6):

[(i) Subparagraphs (A)(iii)(II), (B)(ii), and (C)(iii)(III) of section 904(d)(2) (relating to exceptions for export financing interest).]

(i) Subclause (I) of section 904(d)(2)(B)(iii).

* * * * *

(e) RULES FOR ALLOCATING INTEREST, ETC.—For purposes of this subchapter—

(1) * * *

* * * * *

(7) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing—

(A) * * *

(B) for direct allocation of interest expense incurred to carry out an integrated financial transaction to any interest (or interest-type income) derived from such transaction *and in other circumstances where such allocation would be appropriate to carry out the purposes of this subsection,*

* * * * *

(E) for appropriate adjustments in the application of paragraph (3) in the case of an insurance company, [and]

(F) preventing assets or interest expense from being taken into account more than once, and

[(F)] (G) that this subsection shall not apply for purposes of any provision of this subchapter to the extent the Secretary determines that the application of this subsection for such purposes would not be appropriate.

(f) ELECTION TO ALLOCATE INTEREST, ETC. ON WORLDWIDE BASIS.—For purposes of this subchapter, at the election of the worldwide affiliated group—

(1) ALLOCATION AND APPORTIONMENT OF INTEREST EXPENSE.—

(A) IN GENERAL.—The taxable income of each domestic corporation which is a member of a worldwide affiliated group shall be determined by allocating and apportioning interest expense of each member as if all members of such group were a single corporation.

(B) TREATMENT OF WORLDWIDE AFFILIATED GROUP.—The taxable income of the domestic members of a worldwide affiliated group from sources outside the United States shall be determined by allocating and apportioning the interest expense of such domestic members to such income in an amount equal to the excess (if any) of—

(i) the total interest expense of the worldwide affiliated group multiplied by the ratio which the foreign assets of the worldwide affiliated group bears to all the assets of the worldwide affiliated group, over

(ii) the interest expense of all foreign corporations which are members of the worldwide affiliated group to the extent such interest expense of such foreign corporations would have been allocated and apportioned to foreign source income if this subsection were applied to a group consisting of all the foreign corporations in such worldwide affiliated group.

(C) WORLDWIDE AFFILIATED GROUP.—For purposes of this paragraph, the term “worldwide affiliated group” means a group consisting of—

(i) the includible members of an affiliated group (as defined in section 1504(a), determined without regard to paragraphs (2) and (4) of section 1504(b)), and

(ii) all controlled foreign corporations in which such members in the aggregate meet the ownership requirements of section 1504(a)(2) either directly or indirectly through applying paragraph (2) of section 958(a) or through applying rules similar to the rules of such paragraph to stock owned directly or indirectly by domestic partnerships, trusts, or estates.

(2) ALLOCATION AND APPORTIONMENT OF OTHER EXPENSES.—Expenses other than interest which are not directly allocable or apportioned to any specific income producing activity shall be allocated and apportioned as if all members of the affiliated group were a single corporation. For purposes of the preceding sentence, the term “affiliated group” has the meaning given such term by section 1504 (determined without regard to paragraph (4) of section 1504(b)).

(3) TREATMENT OF TAX-EXEMPT ASSETS; BASIS OF STOCK IN NONAFFILIATED 10-PERCENT OWNED CORPORATIONS.—The rules

of paragraphs (3) and (4) of subsection (e) shall apply for purposes of this subsection; except that paragraph (4) shall be applied on worldwide affiliated group basis.

(4) TREATMENT OF CERTAIN FINANCIAL INSTITUTIONS.—

(A) IN GENERAL.—For purposes of paragraph (1), any corporation described in subparagraph (B) shall be treated as an includible corporation for purposes of section 1504 only for purposes of applying this subsection separately to corporations so described.

(B) DESCRIPTION.—A corporation is described in this subparagraph if—

(i) such corporation is a financial institution described in section 581 or 591,

(ii) the business of such financial institution is predominantly with persons other than related persons (within the meaning of subsection (d)(4)) or their customers, and

(iii) such financial institution is required by State or Federal law to be operated separately from any other entity which is not such an institution.

(C) TREATMENT OF BANK HOLDING COMPANIES.—To the extent provided in regulations—

(i) a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a))),

(ii) a financial holding company (within the meaning of section 2(p) of such Act), and

(iii) any subsidiary of a financial institution described in section 581 or 591, or any such bank or financial holding company, if such subsidiary is predominantly engaged (directly or indirectly) in the active conduct of a banking, financing, or similar business,

shall be treated as a corporation described in subparagraph (B).

(5) ELECTION TO EXPAND FINANCIAL INSTITUTION GROUP OF WORLDWIDE GROUP.—

(A) IN GENERAL.—If a worldwide affiliated group elects the application of this subsection, all financial corporations which—

(i) are members of such worldwide affiliated group, but

(ii) are not corporations described in paragraph (4)(B),

shall be treated as described in paragraph (4)(B) for purposes of applying paragraph (4)(A). This subsection (other than this paragraph) shall apply to any such group in the same manner as this subsection (other than this paragraph) applies to the pre-election worldwide affiliated group of which such group is a part.

(B) FINANCIAL CORPORATION.—For purposes of this paragraph, the term “financial corporation” means any corporation if at least 80 percent of its gross income is income described in section 904(d)(2)(D)(ii) and the regulations

thereunder which is derived from transactions with persons who are not related (within the meaning of section 267(b) or 707(b)(1)) to the corporation. For purposes of the preceding sentence, there shall be disregarded any item of income or gain from a transaction or series of transactions a principal purpose of which is the qualification of any corporation as a financial corporation.

(C) *ANTIABUSE RULES.—In the case of a corporation which is a member of an electing financial institution group, to the extent that such corporation—*

(i) distributes dividends or makes other distributions with respect to its stock after the date of the enactment of this paragraph to any member of the pre-election worldwide affiliated group (other than to a member of the electing financial institution group) in excess of the greater of—

(I) its average annual dividend (expressed as a percentage of current earnings and profits) during the 5-taxable-year period ending with the taxable year preceding the taxable year, or

(II) 25 percent of its average annual earnings and profits for such 5-taxable-year period, or

(ii) deals with any person in any manner not clearly reflecting the income of the corporation (as determined under principles similar to the principles of section 482),

an amount of indebtedness of the electing financial institution group equal to the excess distribution or the understatement or overstatement of income, as the case may be, shall be recharacterized (for the taxable year and subsequent taxable years) for purposes of this paragraph as indebtedness of the worldwide affiliated group (excluding the electing financial institution group). If a corporation has not been in existence for 5 taxable years, this subparagraph shall be applied with respect to the period it was in existence.

(D) *ELECTION.—An election under this paragraph with respect to any financial institution group may be made only by the common parent of the pre-election worldwide affiliated group and may be made only for the first taxable year beginning after December 31, 2008, in which such affiliated group includes 1 or more financial corporations. Such an election, once made, shall apply to all financial corporations which are members of the electing financial institution group for such taxable year and all subsequent years unless revoked with the consent of the Secretary.*

(E) *DEFINITIONS RELATING TO GROUPS.—For purposes of this paragraph—*

(i) PRE-ELECTION WORLDWIDE AFFILIATED GROUP.—The term “pre-election worldwide affiliated group” means, with respect to a corporation, the worldwide affiliated group of which such corporation would (but for an election under this paragraph) be a member for purposes of applying paragraph (1).

(ii) *ELECTING FINANCIAL INSTITUTION GROUP.*—The term “electing financial institution group” means the group of corporations to which this subsection applies separately by reason of the application of paragraph (4)(A) and which includes financial corporations by reason of an election under subparagraph (A).

(F) *REGULATIONS.*—The Secretary shall prescribe such regulations as may be appropriate to carry out this subsection, including regulations—

(i) providing for the direct allocation of interest expense in other circumstances where such allocation would be appropriate to carry out the purposes of this subsection,

(ii) preventing assets or interest expense from being taken into account more than once, and

(iii) dealing with changes in members of any group (through acquisitions or otherwise) treated under this paragraph as an affiliated group for purposes of this subsection.

(6) *ELECTION.*—An election to have this subsection apply with respect to any worldwide affiliated group may be made only by the common parent of the domestic affiliated group referred to in paragraph (1)(C) and may be made only for the first taxable year beginning after December 31, 2008, in which a worldwide affiliated group exists which includes such affiliated group and at least one foreign corporation. Such an election, once made, shall apply to such common parent and all other corporations which are members of such worldwide affiliated group for such taxable year and all subsequent years unless revoked with the consent of the Secretary.

[(f)] (g) *ALLOCATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.*—

(1) * * *

* * * *

PART II—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

* * * *

Subpart A—Nonresident Alien Individuals

* * * *

SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

(a) * * *

* * * *

(i) **TAX NOT TO APPLY TO CERTAIN INTEREST AND DIVIDENDS.**—

(1) **IN GENERAL.**—No tax shall be imposed under paragraph (1)(A) or (1)(C) of subsection (a) on any amount described in paragraph (2).

(2) **AMOUNTS TO WHICH PARAGRAPH (1) APPLIES.**—The amounts described in this paragraph are as follows:

(A) * * *

* * * * *

(D) Dividends paid by a foreign corporation which are treated under section 861(a)(2)(B) as income from sources within the United States.

* * * * *

(k) EXEMPTION FOR CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.—

(1) INTEREST-RELATED DIVIDENDS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on any interest-related dividend received from a regulated investment company.

(B) EXCEPTIONS.—Subparagraph (A) shall not apply—

(i) to any interest-related dividend received from a regulated investment company by a person to the extent such dividend is attributable to interest (other than interest described in subparagraph (E) (i) or (iii)) received by such company on indebtedness issued by such person or by any corporation or partnership with respect to which such person is a 10-percent shareholder,

(ii) to any interest-related dividend with respect to stock of a regulated investment company unless the person who would otherwise be required to deduct and withhold tax from such dividend under chapter 3 receives a statement (which meets requirements similar to the requirements of subsection (h)(5)) that the beneficial owner of such stock is not a United States person, and

(iii) to any interest-related dividend paid to any person within a foreign country (or any interest-related dividend payment addressed to, or for the account of, persons within such foreign country) during any period described in subsection (h)(6) with respect to such country.

Clause (iii) shall not apply to any dividend with respect to any stock which was acquired on or before the date of the publication of the Secretary's determination under subsection (h)(6).

(C) INTEREST-RELATED DIVIDEND.—For purposes of this paragraph, an interest-related dividend is any dividend (or part thereof) which is designated by the regulated investment company as an interest-related dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified net interest income of the company for such taxable year, the portion of each distribution which shall be an interest-related dividend shall be only that portion of the amounts so designated which such

qualified net interest income bears to the aggregate amount so designated.

(D) QUALIFIED NET INTEREST INCOME.—For purposes of subparagraph (C), the term “qualified net interest income” means the qualified interest income of the regulated investment company reduced by the deductions properly allocable to such income.

(E) QUALIFIED INTEREST INCOME.—For purposes of subparagraph (D), the term “qualified interest income” means the sum of the following amounts derived by the regulated investment company from sources within the United States:

(i) Any amount includible in gross income as original issue discount (within the meaning of section 1273) on an obligation payable 183 days or less from the date of original issue (without regard to the period held by the company).

(ii) Any interest includible in gross income (including amounts recognized as ordinary income in respect of original issue discount or market discount or acquisition discount under part V of subchapter P and such other amounts as regulations may provide) on an obligation which is in registered form; except that this clause shall not apply to—

(I) any interest on an obligation issued by a corporation or partnership if the regulated investment company is a 10-percent shareholder in such corporation or partnership, and

(II) any interest which is treated as not being portfolio interest under the rules of subsection (h)(4).

(iii) Any interest referred to in subsection (i)(2)(A) (without regard to the trade or business of the regulated investment company).

(iv) Any interest-related dividend includable in gross income with respect to stock of another regulated investment company.

(F) 10-PERCENT SHAREHOLDER.—For purposes of this paragraph, the term “10-percent shareholder” has the meaning given such term by subsection (h)(3)(B).

(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on any short-term capital gain dividend received from a regulated investment company.

(B) EXCEPTION FOR ALIENS TAXABLE UNDER SUBSECTION (a)(2).—Subparagraph (A) shall not apply in the case of any nonresident alien individual subject to tax under subsection (a)(2).

(C) SHORT-TERM CAPITAL GAIN DIVIDEND.—For purposes of this paragraph, a short-term capital gain dividend is any dividend (or part thereof) which is designated by the regulated investment company as a short-term capital gain dividend in a written notice mailed to its shareholders not

later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified short-term gain of the company for such taxable year, the portion of each distribution which shall be a short-term capital gain dividend shall be only that portion of the amounts so designated which such qualified short-term gain bears to the aggregate amount so designated.

(D) **QUALIFIED SHORT-TERM GAIN.**—For purposes of subparagraph (C), the term “qualified short-term gain” means the excess of the net short-term capital gain of the regulated investment company for the taxable year over the net long-term capital loss (if any) of such company for such taxable year. For purposes of this subparagraph—

(i) the net short-term capital gain of the regulated investment company shall be computed by treating any short-term capital gain dividend includible in gross income with respect to stock of another regulated investment company as a short-term capital gain, and

(ii) the excess of the net short-term capital gain for a taxable year over the net long-term capital loss for a taxable year (to which an election under section 4982(e)(4) does not apply) shall be determined without regard to any net capital loss or net short-term capital loss attributable to transactions after October 31 of such year, and any such net capital loss or net short-term capital loss shall be treated as arising on the 1st day of the next taxable year.

To the extent provided in regulations, clause (ii) shall apply also for purposes of computing the taxable income of the regulated investment company.

[(k)] (l) **CROSS REFERENCES.**—

(1) For tax treatment of certain amounts distributed by the United States to nonresident alien individuals, see section 402(e)(2).

* * * * *

SEC. 877. EXPATRIATION TO AVOID TAX.

[(a) **TREATMENT OF EXPATRIATES.**—

[(1) **IN GENERAL.**—Every nonresident alien individual who, within the 10-year period immediately preceding the close of the taxable year, lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B, shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection (after any reduction in such tax under the last sentence of such subsection) exceeds the tax which, without regard to this section, is imposed pursuant to section 871.

[(2) **CERTAIN INDIVIDUALS TREATED AS HAVING TAX AVOIDANCE PURPOSE.**—For purposes of paragraph (1), an individual shall be treated as having a principal purpose to avoid such taxes if—

[(A) the average annual net income tax (as defined in section 38(c)(1) of such individual for the period of 5 taxable years ending before the date of the loss of United States citizenship is greater than \$100,000, or

[(B) the net worth of the individual as of such date is \$500,000 or more.

In the case of the loss of United States citizenship in any calendar year after 1996, such \$100,000 and \$500,000 amounts shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting “1994” for “1992” in subparagraph (B) thereof. Any increase under the preceding sentence shall be rounded to the nearest multiple of \$1,000.]

(a) *TREATMENT OF EXPATRIATES.*—

(1) *IN GENERAL.*—*Every nonresident alien individual to whom this section applies and who, within the 10-year period immediately preceding the close of the taxable year, lost United States citizenship shall be taxable for such taxable year in the manner provided in subsection (b) if the tax imposed pursuant to such subsection (after any reduction in such tax under the last sentence of such subsection) exceeds the tax which, without regard to this section, is imposed pursuant to section 871.*

(2) *INDIVIDUALS SUBJECT TO THIS SECTION.*—*This section shall apply to any individual if—*

(A) *the average annual net income tax (as defined in section 38(c)(1)) of such individual for the period of 5 taxable years ending before the date of the loss of United States citizenship is greater than \$122,000,*

(B) *the net worth of the individual as of such date is \$2,000,000 or more, or*

(C) *such individual fails to certify under penalty of perjury that he has met the requirements of this title for the 5 preceding taxable years or fails to submit such evidence of such compliance as the Secretary may require.*

In the case of the loss of United States citizenship in any calendar year after 2003, such \$122,000 amount shall be increased by an amount equal to such dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting “2002” for “1992” in subparagraph (B) thereof. Any increase under the preceding sentence shall be rounded to the nearest multiple of \$1,000.

* * * * *

[(c) *TAX AVOIDANCE NOT PRESUMED IN CERTAIN CASES.*—

[(1) *IN GENERAL.*—Subsection (a)(2) shall not apply to an individual if—

[(A) such individual is described in a subparagraph of paragraph (2) of this subsection, and

[(B) within the 1-year period beginning on the date of the loss of United States citizenship, such individual submits a ruling request for the Secretary’s determination as to whether such loss has for one of its principal purposes the avoidance of taxes under this subtitle or subtitle B.

[(2) *INDIVIDUALS DESCRIBED.*—

【(A) DUAL CITIZENSHIP, ETC.—An individual is described in this subparagraph if—

【(i) the individual became at birth a citizen of the United States and a citizen of another country and continues to be a citizen of such other country, or

【(ii) the individual becomes (not later than the close of a reasonable period after loss of United States citizenship) a citizen of the country in which—

【(I) such individual was born,

【(II) if such individual is married, such individual's spouse was born, or

【(III) either of such individual's parents were born.

【(B) LONG-TERM FOREIGN RESIDENTS.—An individual is described in this subparagraph if, for each year in the 10- year period ending on the date of loss of United States citizenship, the individual was present in the United States for 30 days or less. The rule of section 7701(b)(3)(D)(ii) shall apply for purposes of this subparagraph.

【(C) RENUNCIATION UPON REACHING AGE OF MAJORITY.—An individual is described in this subparagraph if the individual's loss of United States citizenship occurs before such individual attains age 18-1/2.

【(D) INDIVIDUALS SPECIFIED IN REGULATIONS.—An individual is described in this subparagraph if the individual is described in a category of individuals prescribed by regulation by the Secretary.】

(c) *EXCEPTIONS.*—

(1) *IN GENERAL.*—*Subparagraphs (A) and (B) of subsection (a)(2) shall not apply to an individual described in paragraph (2) or (3).*

(2) *DUAL CITIZENS.*—

(A) *IN GENERAL.*—*An individual is described in this paragraph if—*

(i) the individual became at birth a citizen of the United States and a citizen of another country and continues to be a citizen of such other country, and

(ii) the individual has had no substantial contacts with the United States.

(B) *SUBSTANTIAL CONTACTS.*—*An individual shall be treated as having no substantial contacts with the United States only if the individual—*

(i) was never a resident of the United States (as defined in section 7701(b)),

(ii) has never held a United States passport, and

(iii) was not present in the United States for more than 30 days during any calendar year which is 1 of the 10 calendar years preceding the individual's loss of United States citizenship.

(3) *CERTAIN MINORS.*—*An individual is described in this paragraph if—*

(A) the individual became at birth a citizen of the United States,

(B) neither parent of such individual was a citizen of the United States at the time of such birth,

(C) the individual's loss of United States citizenship occurs before such individual attains age 18½, and

(D) the individual was not present in the United States for more than 30 days during any calendar year which is 1 of the 10 calendar years preceding the individual's loss of United States citizenship.

* * * * *

(g) PHYSICAL PRESENCE.—

(1) IN GENERAL.—This section shall not apply to any individual to whom this section would otherwise apply for any taxable year during the 10-year period referred to in subsection (a) in which such individual is physically present in the United States at any time on more than 30 days in the calendar year ending in such taxable year, and such individual shall be treated for purposes of this title as a citizen or resident of the United States, as the case may be, for such taxable year.

(2) EXCEPTION.—

(A) IN GENERAL.—In the case of an individual described in any of the following subparagraphs of this paragraph, a day of physical presence in the United States shall be disregarded if the individual is performing services in the United States on such day for an employer. The preceding sentence shall not apply if—

(i) such employer is related (within the meaning of section 267 and 707) to such individual, or

(ii) such employer fails to meet such requirements as the Secretary may prescribe by regulations to prevent the avoidance of the purposes of this paragraph. Not more than 30 days during any calendar year may be disregarded under this subparagraph.

(B) INDIVIDUALS WITH TIES TO OTHER COUNTRIES.—An individual is described in this subparagraph if—

(i) the individual becomes (not later than the close of a reasonable period after loss of United States citizenship or termination of residency) a citizen or resident of the country in which—

(I) such individual was born,

(II) if such individual is married, such individual's spouse was born, or

(III) either of such individual's parents were born, and

(ii) the individual becomes fully liable for income tax in such country.

(C) MINIMAL PRIOR PHYSICAL PRESENCE IN THE UNITED STATES.—An individual is described in this subparagraph if, for each year in the 10-year period ending on the date of loss of United States citizenship or termination of residency, the individual was physically present in the United States for 30 days or less. The rule of section

7701(b)(3)(D)(ii) shall apply for purposes of this subparagraph.

* * * * *

Subpart B—Foreign Corporations

* * * * *

SEC. 881. TAX ON INCOME OF FOREIGN CORPORATIONS NOT CONNECTED WITH UNITED STATES BUSINESS.

(a) * * *

* * * * *

(e) TAX NOT TO APPLY TO CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.—

(1) INTEREST-RELATED DIVIDENDS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1) of subsection (a) on any interest-related dividend (as defined in section 871(k)(1)) received from a regulated investment company.

(B) EXCEPTION.—Subparagraph (A) shall not apply—

(i) to any dividend referred to in section 871(k)(1)(B), and

(ii) to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company from a person who is a related person (within the meaning of section 864(d)(4)) with respect to such controlled foreign corporation.

(C) TREATMENT OF DIVIDENDS RECEIVED BY CONTROLLED FOREIGN CORPORATIONS.—The rules of subsection (c)(5)(A) shall apply to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company which is described in clause (ii) of section 871(k)(1)(E) (and not described in clause (i) or (iii) of such section).

(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—No tax shall be imposed under paragraph (1) of subsection (a) on any short-term capital gain dividend (as defined in section 871(k)(2)) received from a regulated investment company.

[(e)] (f) CROSS REFERENCE.—

For doubling of tax on corporations of certain foreign countries, see section 891.

For special rules for original issue discount, see section 871(g).

* * * * *

Subpart D—Miscellaneous Provisions

* * * * *

SEC. 897. DISPOSITION OF INVESTMENT IN UNITED STATES REAL PROPERTY.

(a) * * *

* * * * *

(h) SPECIAL RULES FOR **[REITS]** *CERTAIN INVESTMENT ENTITIES.*—For purposes of this section—

(1) LOOK-THROUGH OF DISTRIBUTIONS.—Any distribution by a **[REIT]** *qualified investment entity* to a nonresident alien individual or a foreign corporation shall, to the extent attributable to gain from sales or exchanges by the **[REIT]** *qualified investment entity* of United States real property interests, be treated as gain recognized by such nonresident alien individual or foreign corporation from the sale or exchange of a United States real property interest.

[(2) SALE OF STOCK IN DOMESTICALLY-CONTROLLED REIT NOT TAXED.—The term “United States real property interest” does not include any interest in a domestically-controlled REIT.

[(3) DISTRIBUTIONS BY DOMESTICALLY-CONTROLLED REITS.—In the case of a domestically-controlled REIT, rules similar to the rules of subsection (d) shall apply to the foreign ownership percentage of any gain.]

(2) SALE OF STOCK IN DOMESTICALLY CONTROLLED ENTITY NOT TAXED.—*The term “United States real property interest” does not include any interest in a domestically controlled qualified investment entity.*

(3) DISTRIBUTIONS BY DOMESTICALLY CONTROLLED QUALIFIED INVESTMENT ENTITIES.—*In the case of a domestically controlled qualified investment entity, rules similar to the rules of subsection (d) shall apply to the foreign ownership percentage of any gain.*

(4) DEFINITIONS.—

[(A) REIT.—The term “REIT” means a real estate investment trust.

[(B) DOMESTICALLY-CONTROLLED REIT.—The term “domestically-controlled REIT” means a REIT in which at all times during the testing period less than 50 percent in value of the stock was held directly or indirectly by foreign persons.]

(A) QUALIFIED INVESTMENT ENTITY.—*The term “qualified investment entity” means any real estate investment trust and any regulated investment company.*

(B) DOMESTICALLY CONTROLLED.—*The term “domestically controlled qualified investment entity” means any qualified investment entity in which at all times during the testing period less than 50 percent in value of the stock was held directly or indirectly by foreign persons.*

(C) FOREIGN OWNERSHIP PERCENTAGE.—The term “foreign ownership percentage” means that percentage of the stock of the **[REIT]** *qualified investment entity* which was held (directly or indirectly) by foreign persons at the time during the testing period during which the direct and indirect ownership of stock by foreign persons was greatest.

(D) TESTING PERIOD.—The term “testing period” means whichever of the following periods is the shortest:

- (i) * * *
- * * * * *
- (iii) the period during which the **REIT** *qualified investment entity* was in existence.
- * * * * *

SEC. 898. TAXABLE YEAR OF CERTAIN FOREIGN CORPORATIONS.

(a) * * *

(b) SPECIFIED FOREIGN CORPORATION.—For purposes of this section—

(1) IN GENERAL.—The term “specified foreign corporation” means any foreign corporation—

[(A) which is—

[(i) treated as a controlled foreign corporation for any purpose under subpart F of part III of this subchapter, or

[(ii) a foreign personal holding company (as defined in section 552), and]

(A) which is treated as a controlled foreign corporation for any purpose under subpart F of part III of this subchapter, and

* * * * *

(2) OWNERSHIP REQUIREMENTS.—

(A) * * *

(B) OWNERSHIP.—For purposes of subparagraph (A), the rules of subsections (a) and (b) of section 958 [and sections 551(f) and 554, whichever are applicable,] shall apply in determining ownership.

[(3) UNITED STATES SHAREHOLDER.—

[(A) IN GENERAL.—The term “United States shareholder” has the meaning given to such term by section 951(b), except that, in the case of a foreign corporation having related person insurance income (as defined in section 953(c)(2)), the Secretary may treat any person as a United States shareholder for purposes of this section if such person is treated as a United States shareholder under section 953(c)(1).

[(B) FOREIGN PERSONAL HOLDING COMPANIES.—In the case of any foreign personal holding company (as defined in section 552) which is not a specified foreign corporation by reason of paragraph (1)(A)(i), the term “United States shareholder” means any person who is treated as a United States shareholder under section 551.]

(3) UNITED STATES SHAREHOLDER.—The term “United States shareholder” has the meaning given to such term by section 951(b), except that, in the case of a foreign corporation having related person insurance income (as defined in section 953(c)(2)), the Secretary may treat any person as a United States shareholder for purposes of this section if such person is treated as a United States shareholder under section 953(c)(1).

[(C) DETERMINATION OF REQUIRED YEAR.—

[(1) CONTROLLED FOREIGN CORPORATIONS.—

[(A) IN GENERAL.—In the case of a specified foreign corporation described in subsection (b)(1)(A)(i), the required year is—

[(i) the majority U.S. shareholder year, or

[(ii) if there is no majority U.S. shareholder year, the taxable year prescribed under regulations.

[(B) 1-MONTH DEFERRAL ALLOWED.—A specified foreign corporation may elect, in lieu of the taxable year under subparagraph (A)(i), a taxable year beginning 1 month earlier than the majority U.S. shareholder year.

[(C) MAJORITY U.S. SHAREHOLDER YEAR.—

[(i) IN GENERAL.—For purposes of this subsection, the term “majority U.S. shareholder year” means the taxable year (if any) which, on each testing day, constituted the taxable year of—

[(I) each United States shareholder described in subsection (b)(2)(A), and

[(II) each United States shareholder not described in subclause (I) whose stock was treated as owned under subsection (b)(2)(B) by any shareholder described in such subclause.

[(ii) TESTING DAY.—The testing days shall be—

[(I) the first day of the corporation’s taxable year (determined without regard to this section), or

[(II) the days during such representative period as the Secretary may prescribe.

[(2) FOREIGN PERSONAL HOLDING COMPANIES.—In the case of a foreign personal holding company described in subsection (b)(3)(B), the required year shall be determined under paragraph (1), except that subparagraph (B) of paragraph (1) shall not apply.】

(c) DETERMINATION OF REQUIRED YEAR.—

(1) IN GENERAL.—*The required year is—*

(A) the majority U.S. shareholder year, or

(B) if there is no majority U.S. shareholder year, the taxable year prescribed under regulations.

(2) 1-MONTH DEFERRAL ALLOWED.—*A specified foreign corporation may elect, in lieu of the taxable year under paragraph (1)(A), a taxable year beginning 1 month earlier than the majority U.S. shareholder year.*

(3) MAJORITY U.S. SHAREHOLDER YEAR.—

(A) IN GENERAL.—*For purposes of this subsection, the term “majority U.S. shareholder year” means the taxable year (if any) which, on each testing day, constituted the taxable year of—*

(i) each United States shareholder described in subsection (b)(2)(A), and

(ii) each United States shareholder not described in clause (i) whose stock was treated as owned under subsection (b)(2)(B) by any shareholder described in such clause.

(B) TESTING DAY.—*The testing days shall be—*

(i) the first day of the corporation's taxable year
(determined without regard to this section), or
(ii) the days during such representative period as
the Secretary may prescribe.

* * * * *

PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES

Subpart A. Foreign tax credit.

* * * * *

【Subpart E. Qualifying foreign trade income.】

* * * * *

Subpart A—Foreign Tax Credit

* * * * *

SEC. 901. TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES.

(a) * * *

(b) AMOUNT ALLOWED.—Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) * * *

* * * * *

(5) PARTNERSHIPS AND ESTATES.—In the case of [any individual] any person described in paragraph (1), (2), (3), or (4), who is a member of a partnership or a beneficiary of an estate or trust, the amount of his proportionate share of the taxes (described in such paragraph) of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be. Under rules or regulations prescribed by the Secretary, in the case of any foreign trust of which the settlor or another person would be treated as owner of any portion of the trust under subpart E but for section 672(f), the allocable amount of any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States on the settlor or such other person in respect of trust income.

* * * * *

(k) MINIMUM HOLDING PERIOD FOR CERTAIN TAXES ON DIVIDENDS.—

(1) * * *

* * * * *

(l) MINIMUM HOLDING PERIOD FOR WITHHOLDING TAXES ON GAIN AND INCOME OTHER THAN DIVIDENDS ETC.—

(1) IN GENERAL.—In no event shall a credit be allowed under subsection (a) for any withholding tax (as defined in subsection (k)) on any item of income or gain with respect to any property if—

(A) such property is held by the recipient of the item for 15 days or less during the 30-day period beginning on the

date which is 15 days before the date on which the right to receive payment of such item arises, or

(B) to the extent that the recipient of the item is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

This paragraph shall not apply to any dividend to which subsection (k) applies.

(2) EXCEPTION FOR TAXES PAID BY DEALERS.—

(A) IN GENERAL.—Paragraph (1) shall not apply to any qualified tax with respect to any property held in the active conduct in a foreign country of a business as a dealer in such property.

(B) QUALIFIED TAX.—For purposes of subparagraph (A), the term “qualified tax” means a tax paid to a foreign country (other than the foreign country referred to in subparagraph (A)) if—

(i) the item to which such tax is attributable is subject to taxation on a net basis by the country referred to in subparagraph (A), and

(ii) such country allows a credit against its net basis tax for the full amount of the tax paid to such other foreign country.

(C) DEALER.—For purposes of subparagraph (A), the term “dealer” means—

(i) with respect to a security, any person to whom paragraphs (1) and (2) of subsection (k) would not apply by reason of paragraph (4) thereof if such security were stock, and

(ii) with respect to any other property, any person with respect to whom such property is described in section 1221(a)(1).

(D) REGULATIONS.—The Secretary may prescribe such regulations as may be appropriate to carry out this paragraph, including regulations to prevent the abuse of the exception provided by this paragraph and to treat other taxes as qualified taxes.

(3) EXCEPTIONS.—The Secretary may by regulation provide that paragraph (1) shall not apply to property where the Secretary determines that the application of paragraph (1) to such property is not necessary to carry out the purposes of this subsection.

(4) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (5), (6), and (7) of subsection (k) shall apply for purposes of this subsection.

(5) DETERMINATION OF HOLDING PERIOD.—Holding periods shall be determined for purposes of this subsection without regard to section 1235 or any similar rule.

[(1)] *(m) CROSS REFERENCE.—*

(1) * * *

* * * * *

SEC. 902. DEEMED PAID CREDIT WHERE DOMESTIC CORPORATION OWNS 10 PERCENT OR MORE OF VOTING STOCK OF FOREIGN CORPORATION.

(a) * * *

* * * * *

(c) **DEFINITIONS AND SPECIAL RULES.**—For purposes of this section—

(1) * * *

* * * * *

(7) **CONSTRUCTIVE OWNERSHIP THROUGH PARTNERSHIPS.**—*Stock owned, directly or indirectly, by or for a partnership shall be considered as being owned proportionately by its partners. Stock considered to be owned by a person by reason of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person. The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including rules to account for special partnership allocations of dividends, credits, and other incidents of ownership of stock in determining proportionate ownership.*

[(7)] (8) **REGULATIONS.**—The Secretary shall provide such regulations as may be necessary or appropriate to carry out the provisions of this section and section 960, including provisions which provide for the separate application of this section and section 960 to reflect the separate application of section 904 to separate types of income and loss.

* * * * *

SEC. 904. LIMITATION ON CREDIT.

(a) * * *

(b) **TAXABLE INCOME FOR PURPOSE OF COMPUTING LIMITATION.**—

(1) * * *

* * * * *

(3) **DEFINITIONS.**—For purposes of this subsection—

(A) * * *

* * * * *

(D) **CAPITAL GAIN RATE DIFFERENTIAL.**—There is a capital gain rate differential for any taxable year if—

(i) * * *

[(ii) in the case of a corporation, any rate of tax imposed by section 11, 511, or 831(a) or (b) (whichever applies) exceeds the alternative rate of tax under section 1201(a) (determined without regard to the last sentence of section 11(b)(1)).]

(ii) *in the case of a corporation, section 1201(a) applies to such taxable year.*

* * * * *

(d) **SEPARATE APPLICATION OF SECTION WITH RESPECT TO CERTAIN CATEGORIES OF INCOME.**—

[(1) IN GENERAL.—The provisions of subsections (a), (b), and (c) and sections 902, 907, and 960 shall be applied separately with respect to each of the following items of income:

[(A) passive income,

[(B) high withholding tax interest,

[(C) financial services income,

[(D) shipping income,

[(E) in the case of a corporation, dividends from non-controlled section 902 corporations out of earnings and profits accumulated in taxable years beginning before January 1, 2003,

[(F) dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such dividends are treated as income from sources without the United States,

[(G) taxable income attributable to foreign trade income (within the meaning of section 923(b)),

[(H) distributions from a FSC (or a former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b)) or interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923(b)), and

[(I) income other than income described in any of the preceding subparagraphs.]

(1) IN GENERAL.—*The provisions of subsections (a), (b), and (c) and sections 902, 907, and 960 shall be applied separately with respect to—*

(A) passive category income, and

(B) general category income.

(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) CATEGORIES.—

(i) PASSIVE CATEGORY INCOME.—The term “passive category income” means passive income and specified passive category income.

ii) GENERAL CATEGORY INCOME.—The term “general category income” means income other than passive category income.

[(A)] (B) PASSIVE INCOME.—

(i) * * *

* * * * *

(iii) EXCEPTIONS.—The term “passive income” shall not include—

[(I) any income described in a subparagraph of paragraph (1) other than subparagraph (A),]

[(II)] (I) any export financing interest, and

[(III)] (II) any high-taxed income.

* * * * *

(v) SPECIFIED PASSIVE CATEGORY INCOME.—The term “specified passive category income” means—

(I) dividends from a DISC or former DISC (as defined in section 992(a)) to the extent such divi-

dends are treated as income from sources without the United States,

(II) taxable income attributable to foreign trade income (within the meaning of section 923(b)), and

(III) distributions from a FSC (or a former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b)) or interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923(b)).

[(B) HIGH WITHHOLDING TAX INTEREST.—

[(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term “high withholding tax interest” means any interest if—

[(I) such interest is subject to a withholding tax of a foreign country or possession of the United States (or other tax determined on a gross basis), and

[(II) the rate of such tax applicable to such interest is at least 5 percent.

[(ii) EXCEPTION FOR EXPORT FINANCING.—The term “high withholding tax interest” shall not include any export financing interest.

[(iii) REGULATIONS.—The Secretary may by regulations provide that—

[(I) amounts (not otherwise high withholding tax interest) shall be treated as high withholding tax interest where necessary to prevent avoidance of the purposes of this subparagraph, and

[(II) a tax shall not be treated as a withholding tax or other tax imposed on a gross basis if such tax is in the nature of a prepayment of a tax imposed on a net basis.】

(C) TREATMENT OF FINANCIAL SERVICES INCOME AND COMPANIES.—

(i) IN GENERAL.—Financial services income shall be treated as general category income in the case of—

(I) a member of a financial services group, and

(II) any other person if such person is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business.

(ii) FINANCIAL SERVICES GROUP.—The term “financial services group” means any affiliated group (as defined in section 1504(a) without regard to paragraphs (2) and (3) of section 1504(b)) which is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business. In determining whether such a group is so engaged, there shall be taken into account only the income of members of the group that are—

(I) United States corporations, or

(II) controlled foreign corporations in which such United States corporations own, directly or indirectly, at least 80 percent of the total voting power and value of the stock.

(iii) PASS-THRU ENTITIES.—The Secretary shall by regulation specify for purposes of this subparagraph the treatment of financial services income received or accrued by partnerships and by other pass-thru entities which are not members of a financial services group.

[(C)] (D) FINANCIAL SERVICES INCOME.—

(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term “financial services income” means any income which is received or accrued by any person predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, and which is—

(I) described in clause (ii), or

[(II) passive income (determined without regard to subclauses (I) and (III) of subparagraph (A)(iii)), or

[(III) export financing interest which (but for subparagraph (B)(ii)) would be high withholding tax interest.]

(II) passive income (determined without regard to subparagraph (B)(iii)(II)).

* * * * *

[(iii) EXCEPTIONS.—The term “financial services income” does not include—

[(I) any high withholding tax interest,

[(II) any dividend from a noncontrolled section 902 corporation out of earnings and profits accumulated in taxable years beginning before January 1, 2003, and

[(III) any export financing interest not described in clause (i)(III).]

[(D) SHIPPING INCOME.—The term “shipping income” means any income received or accrued by any person which is of a kind which would be foreign base company shipping income (as defined in section 954(f)). Such term does not include any dividend from a noncontrolled section 902 corporation out of earnings and profits accumulated in taxable years beginning before January 1, 2003 and does not include any financial services income.]

(E) NONCONTROLLED SECTION 902 CORPORATION.—

(i) IN GENERAL.—The term “noncontrolled section 902 corporation” means any foreign corporation with respect to which the taxpayer meets the stock ownership requirements of section 902(a) (or, for purposes of applying paragraph (3) or (4), the requirements of section 902(b)). A controlled foreign corporation shall not be treated as a noncontrolled section 902 corporation with respect to any distribution out of its earnings and profits for periods during which it was a controlled foreign corporation.

[(ii) SPECIAL RULE FOR TAXES ON HIGH-WITHOLDING TAX INTEREST.—If a foreign corporation is a noncontrolled section 902 corporation with respect to the taxpayer, taxes on high withholding tax interest (to the extent imposed at a rate in excess of 5 percent) shall not be treated as foreign taxes for purposes of determining the amount of foreign taxes deemed paid by the taxpayer under section 902.]

[(iii)] (ii) TREATMENT OF INCLUSIONS UNDER SECTION 1293.—If any foreign corporation is a noncontrolled section 902 corporation with respect to the taxpayer, any inclusion under section 1293 with respect to such corporation shall be treated as a dividend from such corporation.

[(iv) ALL NON-PFICS TREATED AS ONE.—All noncontrolled section 902 corporations which are not passive foreign investment companies (as defined in section 1297) shall be treated as one noncontrolled section 902 corporation for purposes of paragraph (1).]

(H) TREATMENT OF INCOME TAX BASE DIFFERENCES.—*Tax imposed under the law of a foreign country or possession of the United States on an amount which does not constitute income under United States tax principles shall be treated as imposed on income described in paragraph (1)(B).*

[(H)] (I) RELATED PERSON.—For purposes of this paragraph, the term “related person” has the meaning given such term by section 954(d)(3), except that such section shall be applied by substituting “the person with respect to whom the determination is being made” for “controlled foreign corporation” each place it appears.

[(I)] (J) TRANSITIONAL RULE.—For purposes of paragraph (1)—

(i) * * *

* * * * *

(K) TRANSITIONAL RULES FOR 2005 CHANGES.—*For purposes of paragraph (1)—*

(i) *taxes carried from any taxable year beginning before January 1, 2005, to any taxable year beginning on or after such date, with respect to any item of income, shall be treated as described in the subparagraph of paragraph (1) in which such income would be described were such taxes paid or accrued in a taxable year beginning on or after such date, and*

(ii) *the Secretary may by regulations provide for the allocation of any carryback of taxes with respect to income to such a taxable year for purposes of allocating such income among the separate categories in effect for such taxable year.*

[Note: The amendment made by section 1074(c)(14) of H.R. 2896 to section 904(d)(2)(A) (shown below) applies to taxable years of foreign corporations beginning after December 31, 2006, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.]

SEC. 904. LIMITATION ON CREDIT.

(a) * * *

* * * * *

(d) SEPARATE APPLICATION OF SECTION WITH RESPECT TO CERTAIN CATEGORIES OF INCOME.—

(1) * * *

(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) CATEGORIES.—

(i) *PASSIVE CATEGORY INCOME.*—The term “passive category income” means passive income and specified passive category income.

(ii) *CERTAIN AMOUNTS INCLUDED.*—Except as provided in clause (iii), the term “passive income” includes, except as provided in subparagraph (E)(iii) or paragraph (3)(I), any amount includible in gross income under section 1293 (relating to certain passive foreign investment companies).

[(3) LOOK-THRU IN CASE OF CONTROLLED FOREIGN CORPORATIONS.—

[(A) IN GENERAL.—Except as otherwise provided in this paragraph, dividends, interest, rents, and royalties received or accrued by the taxpayer from a controlled foreign corporation in which the taxpayer is a United States shareholder shall not be treated as income in a separate category.

[(B) SUBPART F INCLUSIONS.—Any amount included in gross income under section 951(a)(1)(A) shall be treated as income in a separate category to the extent the amount so included is attributable to income in such category.

[(C) INTEREST, RENTS, AND ROYALTIES.—Any interest, rent, or royalty which is received or accrued from a controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as income in a separate category to the extent it is properly allocable (under regulations prescribed by the Secretary) to income of the controlled foreign corporation in such category.

[(D) DIVIDENDS.—Any dividend paid out of the earnings and profits of any controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as income in a separate category in proportion to the ratio of—

[(i) the portion of the earnings and profits attributable to income in such category, to

[(ii) the total amount of earnings and profits.

[(E) LOOK-THRU APPLIES ONLY WHERE SUBPART F APPLIES.—If a controlled foreign corporation meets the requirements of section 954(b)(3)(A) (relating to de minimis rule) for any taxable year, for purposes of this paragraph,

none of its foreign base company income (as defined in section 954(a) without regard to section 954(b)(5)) and none of its gross insurance income (as defined in section 954(b)(3)(C)) for such taxable year shall be treated as income in a separate category, except that this sentence shall not apply to any income which (without regard to this sentence) would be treated as financial services income. Solely for purposes of applying subparagraph (D), passive income of a controlled foreign corporation shall not be treated as income in a separate category if the requirements of section 954(b)(4) are met with respect to such income.

[(F) SEPARATE CATEGORY.—For purposes of this paragraph—

[(i) IN GENERAL.—Except as provided in clause (ii), the term “separate category” means any category of income described in subparagraph (A), (B), (C), (D), or (E) of paragraph (1).

[(ii) COORDINATION WITH HIGH-TAXED INCOME PROVISIONS.—

[(I) In determining whether any income of a controlled foreign corporation is in a separate category, subclause (III) of paragraph (2)(A)(iii) shall not apply.

[(II) Any income of the taxpayer which is treated as income in a separate category under this paragraph shall be so treated notwithstanding any provision of paragraph (2); except that the determination of whether any amount is high-taxed income shall be made after the application of this paragraph.

[(G) DIVIDEND.—For purposes of this paragraph, the term “dividend” includes any amount included in gross income in section 951(a)(1)(B). Any amount included in gross income under section 78 to the extent attributable to amounts included in gross income in section 951(a)(1)(A) shall not be treated as a dividend but shall be treated as included in gross income under section 951(a)(1)(A).

[(H) EXCEPTION FOR CERTAIN HIGH WITHHOLDING TAX INTEREST.—This paragraph shall not apply to any amount which—

[(i) without regard to this paragraph, is high withholding tax interest (including any amount treated as high withholding tax interest under paragraph (2)(B)(iii)), and

[(ii) would (but for this subparagraph) be treated as financial services income under this paragraph.

The amount to which this paragraph does not apply by reason of the preceding sentence shall not exceed the interest or equivalent income of the controlled foreign corporation taken into account in determining financial services income without regard to this subparagraph.

[(I) LOOK-THRU APPLIES TO PASSIVE FOREIGN INVESTMENT COMPANY INCLUSION.—If—

[(i) a passive foreign investment company is a controlled foreign corporation, and

[(ii) the taxpayer is a United States shareholder in such controlled foreign corporation, any amount included in gross income under section 1293 shall be treated as income in a separate category to the extent such amount is attributable to income in such category.

[(4) LOOK-THRU APPLIES TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.—

[(A) IN GENERAL.—For purposes of this subsection, any applicable dividend shall be treated as income in a separate category in proportion to the ratio of—

[(i) the portion of the earnings and profits described in subparagraph (B)(ii) attributable to income in such category, to

[(ii) the total amount of such earnings and profits.

[(B) APPLICABLE DIVIDEND.—For purposes of subparagraph (A), the term “applicable dividend” means any dividend—

[(i) from a noncontrolled section 902 corporation with respect to the taxpayer, and

[(ii) paid out of earnings and profits accumulated in taxable years beginning after December 31, 2002.

[(C) SPECIAL RULES.—

[(i) IN GENERAL.—Rules similar to the rules of paragraph (3)(F) shall apply for purposes of this paragraph.

[(ii) EARNINGS AND PROFITS.—For purposes of this paragraph and paragraph (1)(E)—

[(I) IN GENERAL.—The rules of section 316 shall apply.

[(II) REGULATIONS.—The Secretary may prescribe regulations regarding the treatment of distributions out of earnings and profits for periods prior to the taxpayer’s acquisition of such stock.]

(3) LOOK-THRU IN CASE OF CONTROLLED FOREIGN CORPORATIONS.—

(A) IN GENERAL.—*Except as otherwise provided in this paragraph, dividends, interest, rents, and royalties received or accrued by the taxpayer from a controlled foreign corporation in which the taxpayer is a United States shareholder shall not be treated as passive category income.*

(B) SUBPART F INCLUSIONS.—*Any amount included in gross income under section 951(a)(1)(A) shall be treated as passive category income to the extent the amount so included is attributable to passive category income.*

(C) INTEREST, RENTS, AND ROYALTIES.—*Any interest, rent, or royalty which is received or accrued from a controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as passive category income to the extent it is properly allocable (under regulations prescribed by the Secretary) to passive category income of the controlled foreign corporation.*

(D) *DIVIDENDS.*—Any dividend paid out of the earnings and profits of any controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as passive category income in proportion to the ratio of—

- (i) the portion of the earnings and profits attributable to passive category income, to
- (ii) the total amount of earnings and profits.

(E) *LOOK-THRU APPLIES ONLY WHERE SUBPART F APPLIES.*—If a controlled foreign corporation meets the requirements of section 954(b)(3)(A) (relating to de minimis rule) for any taxable year, for purposes of this paragraph, none of its foreign base company income (as defined in section 954(a) without regard to section 954(b)(5)) and none of its gross insurance income (as defined in section 954(b)(3)(C)) for such taxable year shall be treated as passive category income, except that this sentence shall not apply to any income which (without regard to this sentence) would be treated as financial services income. Solely for purposes of applying subparagraph (D), passive income of a controlled foreign corporation shall not be treated as passive category income if the requirements of section 954(b)(4) are met with respect to such income.

(F) *COORDINATION WITH HIGH-TAXED INCOME PROVISIONS.*—

- (i) In determining whether any income of a controlled foreign corporation is passive category income, subclause (II) of paragraph (2)(B)(iii) shall not apply.

- (ii) Any income of the taxpayer which is treated as passive category income under this paragraph shall be so treated notwithstanding any provision of paragraph (2); except that the determination of whether any amount is high-taxed income shall be made after the application of this paragraph.

(G) *DIVIDEND.*—For purposes of this paragraph, the term “dividend” includes any amount included in gross income in section 951(a)(1)(B). Any amount included in gross income under section 78 to the extent attributable to amounts included in gross income in section 951(a)(1)(A) shall not be treated as a dividend but shall be treated as included in gross income under section 951(a)(1)(A).

(H) *LOOK-THRU APPLIES TO PASSIVE FOREIGN INVESTMENT COMPANY INCLUSION.*—If—

- (i) a passive foreign investment company is a controlled foreign corporation, and

- (ii) the taxpayer is a United States shareholder in such controlled foreign corporation,
- any amount included in gross income under section 1293 shall be treated as income in a separate category to the extent such amount is attributable to income in such category.

(4) *LOOK-THRU APPLIES TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.*—

- (A) *IN GENERAL.*—For purposes of this subsection, any dividend from a noncontrolled section 902 corporation with

respect to the taxpayer shall be treated as income described in a subparagraph of paragraph (1) in proportion to the ratio of—

- (i) the portion of earnings and profits attributable to income described in such subparagraph, to
- (ii) the total amount of earnings and profits.

(B) SPECIAL RULES.—For purposes of this paragraph—

(i) EARNINGS AND PROFITS.—

(I) IN GENERAL.—The rules of section 316 shall apply.

(II) REGULATIONS.—The Secretary may prescribe regulations regarding the treatment of distributions out of earnings and profits for periods before the taxpayer's acquisition of the stock to which the distributions relate.

(ii) INADEQUATE SUBSTANTIATION.—If the Secretary determines that the proper subparagraph of paragraph (1) in which a dividend is described has not been substantiated, such dividend shall be treated as income described in paragraph (1)(A).

(iii) LOOK-THRU WITH RESPECT TO CARRYFORWARDS OF CREDIT.—Rules similar to subparagraph (A) also shall apply to any carryforward under subsection (c) from a taxable year beginning before January 1, 2003, of tax allocable to a dividend from a noncontrolled section 902 corporation with respect to the taxpayer. The Secretary may by regulations provide for the allocation of any carryback of tax allocable to a dividend from a noncontrolled section 902 corporation to such a taxable year for purposes of allocating such dividend among the separate categories in effect for such taxable year.

(iv) COORDINATION WITH HIGH-TAXED INCOME PROVISIONS.—Rules similar to the rules of paragraph (3)(F) shall apply for purposes of this paragraph.

(g) RECHARACTERIZATION OF OVERALL DOMESTIC LOSS.—

(1) GENERAL RULE.—For purposes of this subpart and section 936, in the case of any taxpayer who sustains an overall domestic loss for any taxable year beginning after December 31, 2005, that portion of the taxpayer's taxable income from sources within the United States for each succeeding taxable year which is equal to the lesser of—

(A) the amount of such loss (to the extent not used under this paragraph in prior taxable years), or

(B) 50 percent of the taxpayer's taxable income from sources within the United States for such succeeding taxable year, shall be treated as income from sources without the United States (and not as income from sources within the United States).

(2) OVERALL DOMESTIC LOSS DEFINED.—For purposes of this subsection—

(A) IN GENERAL.—The term “overall domestic loss” means any domestic loss to the extent such loss offsets taxable income from sources without the United States for the

taxable year or for any preceding taxable year by reason of a carryback. For purposes of the preceding sentence, the term “domestic loss” means the amount by which the gross income for the taxable year from sources within the United States is exceeded by the sum of the deductions properly apportioned or allocated thereto (determined without regard to any carryback from a subsequent taxable year).

(B) TAXPAYER MUST HAVE ELECTED FOREIGN TAX CREDIT FOR YEAR OF LOSS.—The term “overall domestic loss” shall not include any loss for any taxable year unless the taxpayer chose the benefits of this subpart for such taxable year.

(3) CHARACTERIZATION OF SUBSEQUENT INCOME.—

(A) IN GENERAL.—Any income from sources within the United States that is treated as income from sources without the United States under paragraph (1) shall be allocated among and increase the income categories in proportion to the loss from sources within the United States previously allocated to those income categories.

(B) INCOME CATEGORY.—For purposes of this paragraph, the term “income category” has the meaning given such term by subsection (f)(5)(E)(i).

(4) COORDINATION WITH SUBSECTION (f).—The Secretary shall prescribe such regulations as may be necessary to coordinate the provisions of this subsection with the provisions of subsection (f).

[(g)] (h) SOURCE RULES IN CASE OF UNITED STATES-OWNED FOREIGN CORPORATIONS.—

(1) IN GENERAL.—The following amounts which are derived from a United States-owned foreign corporation and which would be treated as derived from sources outside the United States without regard to this subsection shall, for purposes of this section, be treated as derived from sources within the United States to the extent provided in this subsection:

(A) Any amount included in gross income under—

(i) section 951(a) (relating to amounts included in gross income of United States shareholders), or

[(ii)] *section 551 (relating to foreign personal holding company income taxed to United States shareholders), or*

[(iii)] *(ii) section 1293 (relating to current taxation of income from qualified funds).*

* * * * *

(2) SUBPART F AND [FOREIGN PERSONAL HOLDING OR] PASSIVE FOREIGN INVESTMENT COMPANY INCLUSIONS.—Any amount described in subparagraph (A) of paragraph (1) shall be treated as derived from sources within the United States to the extent such amount is attributable to income of the United States-owned foreign corporation from sources within the United States.

[(h)] (i) COORDINATION WITH NONREFUNDABLE PERSONAL CREDITS.—In the case of an individual, for purposes of subsection (a), the tax against which the credit is taken is such tax reduced by the sum of the credits allowable under subpart A of part IV of

subchapter A of this chapter. This subsection shall not apply to taxable years beginning during 2000, 2001, 2002, or 2003.

[(i)] (j) LIMITATION ON USE OF DECONSOLIDATION TO AVOID FOREIGN TAX CREDIT LIMITATIONS.—If 2 or more domestic corporations would be members of the same affiliated group if—

(1) * * *

* * * * *

[(j)] (k) CERTAIN INDIVIDUALS EXEMPT.—

(1) * * *

* * * * *

(3) DEFINITIONS.—For purposes of this subsection—

(A) QUALIFIED PASSIVE INCOME.—The term “qualified passive income” means any item of gross income if—

(i) such item of income is passive income (as defined in [(subsection (d)(2)(A))] subsection (d)(2)(B) without regard to clause (iii) thereof), and

[(k)] (l) Cross references

(1) * * *

* * * * *

Subpart D—Possessions of the United States

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SEC. 936. PUERTO RICO AND POSSESSION TAX CREDIT.

(a) ALLOWANCE OF CREDIT.—

(1) * * *

(2) CONDITIONS WHICH MUST BE SATISFIED.—The conditions referred to in paragraph (1) are:

(A) 3-YEAR PERIOD.—If 80 percent or more of the gross income of such domestic corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States (determined without regard to [(section 904(f))] subsections (f) and (g) of section 904); and

* * * * *

[(Subpart E—Qualifying Foreign Trade Income]

[(Sec. 941. Qualifying foreign trade income.

[(Sec. 942. Foreign trading gross receipts.

[(Sec. 943. Other definitions and special rules.

[(SEC. 941. QUALIFYING FOREIGN TRADE INCOME.

[(a) QUALIFYING FOREIGN TRADE INCOME.—For purposes of this subpart and section 114—

[(1) IN GENERAL.—The term “qualifying foreign trade income” means, with respect to any transaction, the amount of gross income which, if excluded, will result in a reduction of the taxable income of the taxpayer from such transaction equal to the greatest of—

[(A) 30 percent of the foreign sale and leasing income derived by the taxpayer from such transaction,

[(B) 1.2 percent of the foreign trading gross receipts derived by the taxpayer from the transaction, or

[(C) 15 percent of the foreign trade income derived by the taxpayer from the transaction.

In no event shall the amount determined under subparagraph (B) exceed 200 percent of the amount determined under subparagraph (C).

[(2) ALTERNATIVE COMPUTATION.—A taxpayer may compute its qualifying foreign trade income under a subparagraph of paragraph (1) other than the subparagraph which results in the greatest amount of such income.

[(3) LIMITATION ON USE OF FOREIGN TRADING GROSS RECEIPTS METHOD.—If any person computes its qualifying foreign trade income from any transaction with respect to any property under paragraph (1)(B), the qualifying foreign trade income of such person (or any related person) with respect to any other transaction involving such property shall be zero.

[(4) RULES FOR MARGINAL COSTING.—The Secretary shall prescribe regulations setting forth rules for the allocation of expenditures in computing foreign trade income under paragraph (1)(C) in those cases where a taxpayer is seeking to establish or maintain a market for qualifying foreign trade property.

[(5) PARTICIPATION IN INTERNATIONAL BOYCOTTS, ETC.—Under regulations prescribed by the Secretary, the qualifying foreign trade income of a taxpayer for any taxable year shall be reduced (but not below zero) by the sum of—

[(A) an amount equal to such income multiplied by the international boycott factor determined under section 999, and

[(B) any illegal bribe, kickback, or other payment (within the meaning of section 162(c)) paid by or on behalf of the taxpayer directly or indirectly to an official, employee, or agent in fact of a government.

[(b) FOREIGN TRADE INCOME.—For purposes of this subpart—

[(1) IN GENERAL.—The term “foreign trade income” means the taxable income of the taxpayer attributable to foreign trading gross receipts of the taxpayer.

[(2) SPECIAL RULE FOR COOPERATIVES.—In any case in which an organization to which part I of subchapter T applies which is engaged in the marketing of agricultural or horticultural products sells qualifying foreign trade property, in computing the taxable income of such cooperative, there shall not be taken into account any deduction allowable under subsection (b) or (c) of section 1382 (relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions).

[(c) FOREIGN SALE AND LEASING INCOME.—For purposes of this section—

[(1) IN GENERAL.—The term “foreign sale and leasing income” means, with respect to any transaction—

[(A) foreign trade income properly allocable to activities which—

[(i) are described in paragraph (2)(A)(i) or (3) of section 942(b), and

[(ii) are performed by the taxpayer (or any person acting under a contract with such taxpayer) outside the United States, or

[(B) foreign trade income derived by the taxpayer in connection with the lease or rental of qualifying foreign trade property for use by the lessee outside the United States.

[(2) SPECIAL RULES FOR LEASED PROPERTY.—

[(A) SALES INCOME.—The term “foreign sale and leasing income” includes any foreign trade income derived by the taxpayer from the sale of property described in paragraph (1)(B).

[(B) LIMITATION IN CERTAIN CASES.—Except as provided in regulations, in the case of property which—

[(i) was manufactured, produced, grown, or extracted by the taxpayer, or

[(ii) was acquired by the taxpayer from a related person for a price which was not determined in accordance with the rules of section 482,

the amount of foreign trade income which may be treated as foreign sale and leasing income under paragraph (1)(B) or subparagraph (A) of this paragraph with respect to any transaction involving such property shall not exceed the amount which would have been determined if the taxpayer had acquired such property for the price determined in accordance with the rules of section 482.

[(3) SPECIAL RULES.—

[(A) EXCLUDED PROPERTY.—Foreign sale and leasing income shall not include any income properly allocable to excluded property described in subparagraph (B) of section 943(a)(3) (relating to intangibles).

[(B) ONLY DIRECT EXPENSES TAKEN INTO ACCOUNT.—For purposes of this subsection, any expense other than a directly allocable expense shall not be taken into account in computing foreign trade income.

[SEC. 942. FOREIGN TRADING GROSS RECEIPTS.

[(a) FOREIGN TRADING GROSS RECEIPTS.—

[(1) IN GENERAL.—Except as otherwise provided in this section, for purposes of this subpart, the term “foreign trading gross receipts” means the gross receipts of the taxpayer which are—

[(A) from the sale, exchange, or other disposition of qualifying foreign trade property,

[(B) from the lease or rental of qualifying foreign trade property for use by the lessee outside the United States,

[(C) for services which are related and subsidiary to—

[(i) any sale, exchange, or other disposition of qualifying foreign trade property by such taxpayer, or

[(ii) any lease or rental of qualifying foreign trade property described in subparagraph (B) by such taxpayer,

[(D) for engineering or architectural services for construction projects located (or proposed for location) outside the United States, or

[(E) for the performance of managerial services for a person other than a related person in furtherance of the production of foreign trading gross receipts described in subparagraph (A), (B), or (C).

Subparagraph (E) shall not apply to a taxpayer for any taxable year unless at least 50 percent of its foreign trading gross receipts (determined without regard to this sentence) for such taxable year is derived from activities described in subparagraph (A), (B), or (C).

[(2) CERTAIN RECEIPTS EXCLUDED ON BASIS OF USE; SUBSIDIZED RECEIPTS EXCLUDED.—The term “foreign trading gross receipts” shall not include receipts of a taxpayer from a transaction if—

[(A) the qualifying foreign trade property or services—

[(i) are for ultimate use in the United States, or

[(ii) are for use by the United States or any instrumentality thereof and such use of qualifying foreign trade property or services is required by law or regulation, or

[(B) such transaction is accomplished by a subsidy granted by the government (or any instrumentality thereof) of the country or possession in which the property is manufactured, produced, grown, or extracted.

[(3) ELECTION TO EXCLUDE CERTAIN RECEIPTS.—The term “foreign trading gross receipts” shall not include gross receipts of a taxpayer from a transaction if the taxpayer elects not to have such receipts taken into account for purposes of this subpart.

[(b) FOREIGN ECONOMIC PROCESS REQUIREMENTS.—

[(1) IN GENERAL.—Except as provided in subsection (c), a taxpayer shall be treated as having foreign trading gross receipts from any transaction only if economic processes with respect to such transaction take place outside the United States as required by paragraph (2).

[(2) REQUIREMENT.—

[(A) IN GENERAL.—The requirements of this paragraph are met with respect to the gross receipts of a taxpayer derived from any transaction if—

[(i) such taxpayer (or any person acting under a contract with such taxpayer) has participated outside the United States in the solicitation (other than advertising), the negotiation, or the making of the contract relating to such transaction, and

[(ii) the foreign direct costs incurred by the taxpayer attributable to the transaction equal or exceed 50 percent of the total direct costs attributable to the transaction.

[(B) ALTERNATIVE 85-PERCENT TEST.—A taxpayer shall be treated as satisfying the requirements of subparagraph (A)(ii) with respect to any transaction if, with respect to each of at least two subparagraphs of paragraph (3), the

foreign direct costs incurred by such taxpayer attributable to activities described in such subparagraph equal or exceed 85 percent of the total direct costs attributable to activities described in such subparagraph.

[(C) DEFINITIONS.—For purposes of this paragraph—

[(i) TOTAL DIRECT COSTS.—The term “total direct costs” means, with respect to any transaction, the total direct costs incurred by the taxpayer attributable to activities described in paragraph (3) performed at any location by the taxpayer or any person acting under a contract with such taxpayer.

[(ii) FOREIGN DIRECT COSTS.—The term “foreign direct costs” means, with respect to any transaction, the portion of the total direct costs which are attributable to activities performed outside the United States.

[(3) ACTIVITIES RELATING TO QUALIFYING FOREIGN TRADE PROPERTY.—The activities described in this paragraph are any of the following with respect to qualifying foreign trade property—

[(A) advertising and sales promotion,

[(B) the processing of customer orders and the arranging for delivery,

[(C) transportation outside the United States in connection with delivery to the customer,

[(D) the determination and transmittal of a final invoice or statement of account or the receipt of payment, and

[(E) the assumption of credit risk.

[(4) ECONOMIC PROCESSES PERFORMED BY RELATED PERSONS.—A taxpayer shall be treated as meeting the requirements of this subsection with respect to any sales transaction involving any property if any related person has met such requirements in such transaction or any other sales transaction involving such property.

[(c) EXCEPTION FROM FOREIGN ECONOMIC PROCESS REQUIREMENT.—

[(1) IN GENERAL.—The requirements of subsection (b) shall be treated as met for any taxable year if the foreign trading gross receipts of the taxpayer for such year do not exceed \$5,000,000.

[(2) RECEIPTS OF RELATED PERSONS AGGREGATED.—All related persons shall be treated as one person for purposes of paragraph (1), and the limitation under paragraph (1) shall be allocated among such persons in a manner provided in regulations prescribed by the Secretary.

[(3) SPECIAL RULE FOR PASS-THRU ENTITIES.—In the case of a partnership, S corporation, or other pass-thru entity, the limitation under paragraph (1) shall apply with respect to the partnership, S corporation, or entity and with respect to each partner, shareholder, or other owner.

[SEC. 943. OTHER DEFINITIONS AND SPECIAL RULES.

[(a) QUALIFYING FOREIGN TRADE PROPERTY.—For purposes of this subpart—

[(1) IN GENERAL.—The term “qualifying foreign trade property” means property—

[(A) manufactured, produced, grown, or extracted within or outside the United States,

[(B) held primarily for sale, lease, or rental, in the ordinary course of trade or business for direct use, consumption, or disposition outside the United States, and

[(C) not more than 50 percent of the fair market value of which is attributable to—

[(i) articles manufactured, produced, grown, or extracted outside the United States, and

[(ii) direct costs for labor (determined under the principles of section 263A) performed outside the United States.

For purposes of subparagraph (C), the fair market value of any article imported into the United States shall be its appraised value, as determined by the Secretary under section 402 of the Tariff Act of 1930 (19 U.S.C. 1401a) in connection with its importation, and the direct costs for labor under clause (ii) do not include costs that would be treated under the principles of section 263A as direct labor costs attributable to articles described in clause (i).

[(2) U.S. TAXATION TO ENSURE CONSISTENT TREATMENT.—Property which (without regard to this paragraph) is qualifying foreign trade property and which is manufactured, produced, grown, or extracted outside the United States shall be treated as qualifying foreign trade property only if it is manufactured, produced, grown, or extracted by—

[(A) a domestic corporation,

[(B) an individual who is a citizen or resident of the United States,

[(C) a foreign corporation with respect to which an election under subsection (e) (relating to foreign corporations electing to be subject to United States taxation) is in effect, or

[(D) a partnership or other pass-thru entity all of the partners or owners of which are described in subparagraph (A), (B), or (C).

Except as otherwise provided by the Secretary, tiered partnerships or pass-thru entities shall be treated as described in subparagraph (D) if each of the partnerships or entities is directly or indirectly wholly owned by persons described in subparagraph (A), (B), or (C).

[(3) EXCLUDED PROPERTY.—The term “qualifying foreign trade property” shall not include—

[(A) property leased or rented by the taxpayer for use by any related person,

[(B) patents, inventions, models, designs, formulas, or processes whether or not patented, copyrights (other than films, tapes, records, or similar reproductions, and other than computer software (whether or not patented), for commercial or home use), goodwill, trademarks, trade brands, franchises, or other like property,

[(C) oil or gas (or any primary product thereof),

[(D) products the transfer of which is prohibited or curtailed to effectuate the policy set forth in paragraph (2)(C) of section 3 of Public Law 96-72, or

[(E) any unprocessed timber which is a softwood.

For purposes of subparagraph (E), the term “unprocessed timber” means any log, cant, or similar form of timber.

[(4) PROPERTY IN SHORT SUPPLY.—If the President determines that the supply of any property described in paragraph (1) is insufficient to meet the requirements of the domestic economy, the President may by Executive order designate the property as in short supply. Any property so designated shall not be treated as qualifying foreign trade property during the period beginning with the date specified in the Executive order and ending with the date specified in an Executive order setting forth the President’s determination that the property is no longer in short supply.

[(b) OTHER DEFINITIONS AND RULES.—For purposes of this subpart—

[(1) TRANSACTION.—

[(A) IN GENERAL.—The term “transaction” means—

[(i) any sale, exchange, or other disposition,

[(ii) any lease or rental, and

[(iii) any furnishing of services.

[(B) GROUPING OF TRANSACTIONS.—To the extent provided in regulations, any provision of this subpart which, but for this subparagraph, would be applied on a transaction-by-transaction basis may be applied by the taxpayer on the basis of groups of transactions based on product lines or recognized industry or trade usage. Such regulations may permit different groupings for different purposes.

[(2) UNITED STATES DEFINED.—The term “United States” includes the Commonwealth of Puerto Rico. The preceding sentence shall not apply for purposes of determining whether a corporation is a domestic corporation.

[(3) RELATED PERSON.—A person shall be related to another person if such persons are treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414, except that determinations under subsections (a) and (b) of section 52 shall be made without regard to section 1563(b).

[(4) GROSS AND TAXABLE INCOME.—Section 114 shall not be taken into account in determining the amount of gross income or foreign trade income from any transaction.

[(c) SOURCE RULE.—Under regulations, in the case of qualifying foreign trade property manufactured, produced, grown, or extracted within the United States, the amount of income of a taxpayer from any sales transaction with respect to such property which is treated as from sources without the United States shall not exceed—

[(1) in the case of a taxpayer computing its qualifying foreign trade income under section 941(a)(1)(B), the amount of the taxpayer’s foreign trade income which would (but for this subsection) be treated as from sources without the United States

if the foreign trade income were reduced by an amount equal to 4 percent of the foreign trading gross receipts with respect to the transaction, and

[(2) in the case of a taxpayer computing its qualifying foreign trade income under section 941(a)(1)(C), 50 percent of the amount of the taxpayer's foreign trade income which would (but for this subsection) be treated as from sources without the United States.

[(d) TREATMENT OF WITHHOLDING TAXES.—

[(1) IN GENERAL.—For purposes of section 114(d), any withholding tax shall not be treated as paid or accrued with respect to extraterritorial income which is excluded from gross income under section 114(a). For purposes of this paragraph, the term “withholding tax” means any tax which is imposed on a basis other than residence and for which credit is allowable under section 901 or 903.

[(2) EXCEPTION.—Paragraph (1) shall not apply to any taxpayer with respect to extraterritorial income from any transaction if the taxpayer computes its qualifying foreign trade income with respect to the transaction under section 941(a)(1)(A).

[(e) ELECTION TO BE TREATED AS DOMESTIC CORPORATION.—

[(1) IN GENERAL.—An applicable foreign corporation may elect to be treated as a domestic corporation for all purposes of this title if such corporation waives all benefits to such corporation granted by the United States under any treaty. No election under section 1362(a) may be made with respect to such corporation.

[(2) APPLICABLE FOREIGN CORPORATION.—For purposes of paragraph (1), the term “applicable foreign corporation” means any foreign corporation if—

[(A) such corporation manufactures, produces, grows, or extracts property in the ordinary course of such corporation's trade or business, or

[(B) substantially all of the gross receipts of such corporation are foreign trading gross receipts.

[(3) PERIOD OF ELECTION.—

[(A) IN GENERAL.—Except as otherwise provided in this paragraph, an election under paragraph (1) shall apply to the taxable year for which made and all subsequent taxable years unless revoked by the taxpayer. Any revocation of such election shall apply to taxable years beginning after such revocation.

[(B) TERMINATION.—If a corporation which made an election under paragraph (1) for any taxable year fails to meet the requirements of subparagraph (A) or (B) of paragraph (2) for any subsequent taxable year, such election shall not apply to any taxable year beginning after such subsequent taxable year.

[(C) EFFECT OF REVOCATION OR TERMINATION.—If a corporation which made an election under paragraph (1) revokes such election or such election is terminated under subparagraph (B), such corporation (and any successor corporation) may not make such election for any of the 5 taxable years beginning with the first taxable year for which

such election is not in effect as a result of such revocation or termination.

[(4) SPECIAL RULES.—

[(A) REQUIREMENTS.—This subsection shall not apply to an applicable foreign corporation if such corporation fails to meet the requirements (if any) which the Secretary may prescribe to ensure that the taxes imposed by this chapter on such corporation are paid.

[(B) EFFECT OF ELECTION, REVOCATION, AND TERMINATION.—

[(i) ELECTION.—For purposes of section 367, a foreign corporation making an election under this subsection shall be treated as transferring (as of the first day of the first taxable year to which the election applies) all of its assets to a domestic corporation in connection with an exchange to which section 354 applies.

[(ii) REVOCATION AND TERMINATION.—For purposes of section 367, if—

[(I)] an election is made by a corporation under paragraph (1) for any taxable year, and

[(II)] such election ceases to apply for any subsequent taxable year,

such corporation shall be treated as a domestic corporation transferring (as of the 1st day of the first such subsequent taxable year to which such election ceases to apply) all of its property to a foreign corporation in connection with an exchange to which section 354 applies.

[(C) ELIGIBILITY FOR ELECTION.—The Secretary may by regulation designate one or more classes of corporations which may not make the election under this subsection.

[(f) RULES RELATING TO ALLOCATIONS OF QUALIFYING FOREIGN TRADE INCOME FROM SHARED PARTNERSHIPS.—

[(1) IN GENERAL.—If—

[(A)] a partnership maintains a separate account for transactions (to which this subpart applies) with each partner,

[(B)] distributions to each partner with respect to such transactions are based on the amounts in the separate account maintained with respect to such partner, and

[(C)] such partnership meets such other requirements as the Secretary may by regulations prescribe, then such partnership shall allocate to each partner items of income, gain, loss, and deduction (including qualifying foreign trade income) from any transaction to which this subpart applies on the basis of such separate account.

[(2) SPECIAL RULES.—For purposes of this subpart, in the case of a partnership to which paragraph (1) applies—

[(A)] any partner's interest in the partnership shall not be taken into account in determining whether such partner is a related person with respect to any other partner, and

[(B)] the election under section 942(a)(3) shall be made separately by each partner with respect to any transaction

for which the partnership maintains separate accounts for each partner.

[(g) EXCLUSION FOR PATRONS OF AGRICULTURAL AND HORTICULTURAL COOPERATIVES.—Any amount described in paragraph (1) or (3) of section 1385(a)—

[(1) which is received by a person from an organization to which part I of subchapter T applies which is engaged in the marketing of agricultural or horticultural products, and

[(2) which is allocable to qualifying foreign trade income and designated as such by the organization in a written notice mailed to its patrons during the payment period described in section 1382(d), shall be treated as qualifying foreign trade income of such person for purposes of section 114. The taxable income of the organization shall not be reduced under section 1382 by reason of any amount to which the preceding sentence applies.

[(h) SPECIAL RULE FOR DISCS.—Section 114 shall not apply to any taxpayer for any taxable year if, at any time during the taxable year, the taxpayer is a member of any controlled group of corporations (as defined in section 927(d)(4), as in effect before the date of the enactment of this subsection) of which a DISC is a member.]

Subpart F—Controlled Foreign Corporations

* * * * *

SEC. 951. AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS

(a) * * *

* * * * *

[(c) COORDINATION WITH ELECTION OF A FOREIGN INVESTMENT COMPANY TO DISTRIBUTE INCOME.—A United States shareholder who, for his taxable year, is a qualified shareholder (within the meaning of section 1247(c)) of a foreign investment company with respect to which an election under section 1247 is in effect shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company.

[(d) COORDINATION WITH FOREIGN PERSONAL HOLDING COMPANY PROVISIONS.—If, but for this subsection, an amount would be included in the gross income of a United States shareholder for any taxable year both under subsection (a)(1)(A)(i) and under section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholder), such amount shall be included in the gross income of such shareholder only under subsection (a)(1)(A).]

[(e)] (c) FOREIGN TRADE INCOME NOT TAKEN INTO ACCOUNT.—
(1) * * *

* * * * *

[(f)] (d) COORDINATION WITH PASSIVE FOREIGN INVESTMENT COMPANY PROVISIONS.—If, but for this subsection, an amount would be included in the gross income of a United States shareholder for any taxable year both under subsection (a)(1)(A)(i) and under section 1293 (relating to current taxation of income from cer-

tain passive foreign investment companies), such amount shall be included in the gross income of such shareholder only under subsection (a)(1)(A).

* * * * *

SEC. 952. SUBPART F INCOME DEFINED.

(a) * * *

* * * * *

(c) LIMITATION.—

(1) IN GENERAL.—

(A) * * *

(B) CERTAIN PRIOR YEAR DEFICITS MAY BE TAKEN INTO ACCOUNT.—

(i) * * *

* * * * *

(iii) QUALIFIED ACTIVITY.—For purposes of this paragraph, the term “qualified activity” means any activity giving rise to—

[(I) foreign base company shipping income,]

[(II)] (I) foreign base company oil related income,

[(III)] (II) foreign base company sales income,

[(IV)] (III) foreign base company services income,

[(V)] (IV) in the case of a qualified insurance company, insurance income or foreign personal holding company income, or

[(VI)] (V) in the case of a qualified financial institution, foreign personal holding company income.

* * * * *

SEC. 954. FOREIGN BASE COMPANY INCOME.

(a) FOREIGN BASE COMPANY INCOME.—For purposes of section 952(a)(2), the term “foreign base company income” means for any taxable year the sum of—

(1) * * *

* * * * *

[(4) the foreign base company shipping income for the taxable year (determined under subsection (f) and reduced as provided in subsection (b)(5)), and]

* * * * *

(b) EXCLUSIONS AND SPECIAL RULES.—

(1) * * *

* * * * *

(5) DEDUCTIONS TO BE TAKEN INTO ACCOUNT.—For purposes of subsection (a), the foreign personal holding company income, the foreign base company sales income, the foreign base company services income, [the foreign base company shipping income,] and the foreign base company oil related income shall be reduced, under regulations prescribed by the Secretary

so as to take into account deductions (including taxes) properly allocable to such income. Except to the extent provided in regulations prescribed by the Secretary, any interest which is paid or accrued by the controlled foreign corporation to any United States shareholder in such corporation (or any controlled foreign corporation related to such a shareholder) shall be allocated first to foreign personal holding company income which is passive income (within the meaning of section 904(d)(2) of such corporation to the extent thereof. The Secretary may, by regulations, provide that the preceding sentence shall apply also to interest paid or accrued to other persons.

[(6) SPECIAL RULES FOR FOREIGN BASE COMPANY SHIPPING INCOME.—Income of a corporation which is foreign base company shipping income under paragraph (4) of subsection (a)—

[(A) shall not be considered foreign base company income of such corporation under any other paragraph of subsection (a) and

[(B) if distributed through a chain of ownership described under section 958(a), shall not be included in foreign base company income of another controlled foreign corporation in such chain.

[(7) SPECIAL EXCLUSION FOR FOREIGN BASE COMPANY SHIPPING INCOME.—Income of a corporation which is foreign base company shipping income under paragraph (4) of subsection (a) shall be excluded from foreign base company income if derived by a controlled foreign corporation from, or in connection with, the use (or hiring or leasing for use) of an aircraft or vessel in foreign commerce between two points within the foreign country in which such corporation is created or organized and such aircraft or vessel is registered.]

[(8)] (6) FOREIGN BASE COMPANY OIL RELATED INCOME NOT TREATED AS ANOTHER KIND OF BASE COMPANY INCOME.—Income of a corporation which is foreign base company oil related income shall not be considered foreign base company income of such corporation under paragraph (2), or (3) of subsection (a). (c) FOREIGN PERSONAL HOLDING COMPANY INCOME.—

(1) IN GENERAL.—For purposes of subsection (a)(1), the term “foreign personal holding company income” means the portion of the gross income which consists of:

(A) * * *

* * * * *

(C) COMMODITIES TRANSACTIONS.—The excess of gains over losses from transactions (including futures, forward, and similar transactions) in any commodities. This subparagraph shall not apply to gains or losses which—

[(i) arise out of bona fide hedging transactions reasonably necessary to the conduct of any business by a producer, processor, merchant, or handler of a commodity in the manner in which such business is customarily and usually conducted by others,

[(ii) are active business gains or losses from the sale of commodities, but only if substantially all of the controlled foreign corporation’s business is as an active

producer, processor, merchant, or handler of commodities, or]

(i) arise out of commodity hedging transactions (as defined in paragraph (6)(A)),

(ii) are active business gains or losses from the sale of commodities, but only if substantially all of the controlled foreign corporation's commodities are property described in paragraph (1), (2), or (8) of section 1221(a), or

* * * * *

(H) *PERSONAL SERVICE CONTRACTS.*—

(i) Amounts received under a contract under which the corporation is to furnish personal services if—

(I) some person other than the corporation has the right to designate (by name or by description) the individual who is to perform the services, or

(II) the individual who is to perform the services is designated (by name or by description) in the contract, and

(ii) amounts received from the sale or other disposition of such a contract.

This subparagraph shall apply with respect to amounts received for services under a particular contract only if at some time during the taxable year 25 percent or more in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual who has performed, is to perform, or may be designated (by name or by description) as the one to perform, such services.

(2) *EXCEPTION FOR CERTAIN AMOUNTS.*—

(A) *RENTS AND ROYALTIES DERIVED IN ACTIVE BUSINESS.*—Foreign personal holding company income shall not include rents and royalties which are derived in the active conduct of a trade or business and which are received from a person other than a related person (within the meaning of subsection (d)(3)). *For purposes of the preceding sentence, rents derived from leasing an aircraft or vessel in foreign commerce shall not fail to be treated as derived in the active conduct of a trade or business if, as determined under regulations prescribed by the Secretary, the active leasing expenses are not less than 10 percent of the profit on the lease.*

* * * * *

(4) *LOOK-THRU IN THE CASE OF RELATED CONTROLLED FOREIGN CORPORATIONS.*—*For purposes of this subsection, dividends, interest, rents, and royalties received or accrued from a controlled foreign corporation which is a related person (as defined in subsection (d)(3)) shall not be treated as foreign personal holding company income to the extent attributable or properly allocable (determined under rules similar to the rules of subparagraphs (C) and (D) of section 904(d)(3)) to income of the related person which is not subpart F income (as defined in section 952). The Secretary shall prescribe such regulations as*

may be appropriate to prevent the abuse of the purposes of this paragraph.

(5) LOOK-THRU RULE FOR CERTAIN PARTNERSHIP SALES.—

(A) IN GENERAL.—*In the case of any sale by a controlled foreign corporation of an interest in a partnership with respect to which such corporation is a 25-percent owner, such corporation shall be treated for purposes of this subsection as selling the proportionate share of the assets of the partnership attributable to such interest.*

(B) 25-PERCENT OWNER.—*For purposes of this paragraph, the term “25-percent owner” means a controlled foreign corporation which owns (within the meaning of section 958(a)) 25 percent or more of the capital or profits interest in the partnership.*

(6) DEFINITION AND SPECIAL RULES RELATING TO COMMODITY TRANSACTIONS.—

(A) COMMODITY HEDGING TRANSACTIONS.—*For purposes of paragraph (1)(C)(i), the term “commodity hedging transaction” means any transaction with respect to a commodity if such transaction—*

(i) is a hedging transaction as defined in section 1221(b)(2), determined—

(I) without regard to subparagraph (A)(ii) thereof,

(II) by applying subparagraph (A)(i) thereof by substituting “ordinary property or property described in section 1231(b)” for “ordinary property”, and

(III) by substituting “controlled foreign corporation” for “taxpayer” each place it appears, and

(ii) is clearly identified as such in accordance with section 1221(a)(7).

(B) REGULATIONS.—*The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of paragraph (1)(C) in the case of transactions involving related persons.*

(d) FOREIGN BASE COMPANY SALES INCOME.—

(1) * * *

* * * * *

(5) TREATMENT OF MEMBER STATES OF THE EUROPEAN UNION.—*For purposes of this subsection and subsection (e), in the case of a controlled foreign corporation which is created or organized under the laws of a member state of the European Union, all member states of the European Union shall be treated as 1 country.*

* * * * *

[(f) FOREIGN BASE COMPANY SHIPPING INCOME.—*For purposes of subsection (a)(4), the term “foreign base company shipping income” means income derived from, or in connection with, the use (or hiring or leasing for use) of any aircraft or vessel in foreign commerce, or from, or in connection with the performance of services directly related to the use of any such aircraft, or vessel, or*

from the sale, exchange, or other disposition of any such aircraft or vessel. Such term includes, but is not limited to—

[(1) dividends and interest received from a foreign corporation in respect of which taxes are deemed paid under section 902, and gain from the sale, exchange, or other disposition of stock or obligations of such a foreign corporation to the extent that such dividends, interest, and gains are attributable to foreign base company shipping income, and

[(2) that portion of the distributive share of the income of a partnership attributable to foreign base company shipping income.

Such term includes any income derived from a space or ocean activity (as defined in section 863(d)(2)). Except as provided in paragraph (1), such term shall not include any dividend or interest income which is foreign personal holding company income (as defined in subsection (c)).]

(g) FOREIGN BASE COMPANY OIL RELATED INCOME.—For purposes of this section—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the term “foreign base company oil related income” means foreign oil related income (within the meaning of paragraphs (2) and (3) of section 907(c)) other than income derived from a source within a foreign country in connection with—

(A) oil or gas which was extracted from an oil or gas well located in such foreign country, [or]

(B) oil, gas, or a primary product of oil or gas which is sold by the foreign corporation or a related person for use or consumption within such country or is loaded in such country on a vessel or aircraft as fuel for such vessel or aircraft[.], or

(C) the pipeline transportation of oil or gas within such foreign country.

Such term shall not include any foreign personal holding company income (as defined in subsection (c)).

* * * * *

(h) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF BANKING, FINANCING, OR SIMILAR BUSINESSES.—

(1) * * *

* * * * *

(3) QUALIFIED BANKING OR FINANCING INCOME.—For purposes of this subsection—

(A) * * *

* * * * *

(E) DIRECT CONDUCT OF ACTIVITIES.—For purposes of subparagraph (A)(ii)(II), an activity shall be treated as conducted directly by an eligible controlled foreign corporation or qualified business unit in its home country if the activity is performed by employees of a related person and—

(i) the related person is an eligible controlled foreign corporation the home country of which is the same as the home country of the corporation or unit to which subparagraph (A)(ii)(II) is being applied,

(ii) the activity is performed in the home country of the related person, and

(iii) the related person is compensated on an arm's-length basis for the performance of the activity by its employees and such compensation is treated as earned by such person in its home country for purposes of the home country's tax laws.

* * * * *

SEC. 956. INVESTMENT OF EARNINGS IN UNITED STATES PROPERTY.

(a) * * *

* * * * *

(c) UNITED STATES PROPERTY DEFINED.—

(1) * * *

(2) EXCEPTIONS.—For purposes of subsection (a), the term “United States property” does not include—

[(A) obligations of the United States, money, or deposits with persons carrying on the banking business;]

(A) obligations of the United States, money, or deposits with any corporation with respect to which a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a))) or financial holding company (within the meaning of section 2(p) of such Act) owns directly or indirectly more than 80 percent by vote or value of the stock of such corporation;

* * * * *

(J) deposits of cash or securities made or received on commercial terms in the ordinary course of a United States or foreign person's business as a dealer in securities or in commodities, but only to the extent such deposits are made or received as collateral or margin for (i) a securities loan, notional principal contract, options contract, forward contract, or futures contract, or (ii) any other financial transaction in which the Secretary determines that it is customary to post collateral or margin; [and]

(K) an obligation of a United States person to the extent the principal amount of the obligation does not exceed the fair market value of readily marketable securities sold or purchased pursuant to a sale and repurchase agreement or otherwise posted or received as collateral for the obligation in the ordinary course of its business by a United States or foreign person which is a dealer in securities or commodities[.]; and

(L) securities acquired and held by a controlled foreign corporation in the ordinary course of its business as a dealer in securities if—

(i) the dealer accounts for the securities as securities held primarily for sale to customers in the ordinary course of business, and

(ii) the dealer disposes of the securities (or such securities mature while held by the dealer) within a period consistent with the holding of securities for sale to customers in the ordinary course of business.

For purposes of subparagraphs (J) **[and (K)]**, *(K)*, and *(L)*, the term “dealer in securities” has the meaning given such term by section 475(c)(1), and the term “dealer in commodities” has the meaning given such term by section 475(e), except that such term shall include a futures commission merchant.

* * * * *

Subpart J—Foreign Currency Transactions

* * * * *

SEC. 986. DETERMINATION OF FOREIGN TAXES AND FOREIGN CORPORATION'S EARNINGS AND PROFITS.

(a) FOREIGN INCOME TAXES.—

(1) TRANSLATION OF ACCRUED TAXES.—

(A) * * *

* * * * *

(D) *ELECTIVE EXCEPTION FOR TAXES PAID OTHER THAN IN FUNCTIONAL CURRENCY.*—

(i) IN GENERAL.—At the election of the taxpayer, subparagraph (A) shall not apply to any foreign income taxes the liability for which is denominated in any currency other than in the taxpayer's functional currency.

(ii) APPLICATION TO QUALIFIED BUSINESS UNITS.—An election under this subparagraph may apply to foreign income taxes attributable to a qualified business unit in accordance with regulations prescribed by the Secretary.

(iii) ELECTION.—Any such election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

~~[(D)] (E)~~ CROSS REFERENCE.—

For adjustments where tax is not paid within 2 years, see section 905(c).

* * * * *

SEC. 989. OTHER DEFINITIONS AND SPECIAL RULES.

(a) * * *

(b) APPROPRIATE EXCHANGE RATE.—Except as provided in regulations, for purposes of this subpart, the term “appropriate exchange rate” means—

(1) * * *

* * * * *

(3) in the case of any amounts included in income under section 951(a)(1)(A) **[, 551(a),]** or 1293(a), the average exchange rate for the taxable year of the foreign corporation, or

* * * * *

Subchapter O—Gain or Loss on Disposition of Property

* * * * *

PART II—BASIS RULES OF GENERAL APPLICATION

* * * * *

SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) * * *

(b) **PROPERTY ACQUIRED FROM THE DECEDENT.**—For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

(1) * * *

* * * * *

(5) In the case of decedents dying after August 26, 1937, and before January 1, 2008, property acquired by bequest, devise, or inheritance or by the decedent's estate from the decedent, if the property consists of stock or securities of a foreign corporation, which with respect to its taxable year next preceding the date of the decedent's death was, under the law applicable to such year, a foreign personal holding company. In such case, the basis shall be the fair market value of such property at the date of the decedent's death or the basis in the hands of the decedent, whichever is lower;

* * * * *

SEC. 1016. ADJUSTMENTS TO BASIS.

(a) **GENERAL RULE.**—Proper adjustment in respect of the property shall in all cases be made—

(1) * * *

* * * * *

[(13) to the extent provided in section 551(e) in the case of the stock of United States shareholders in a foreign personal holding company;]

* * * * *

PART III—COMMON NONTAXABLE EXCHANGES

* * * * *

SEC. 1033. INVOLUNTARY CONVERSIONS.

(a) * * *

* * * * *

(e) **LIVESTOCK SOLD ON ACCOUNT OF DROUGHT, FLOOD, OR OTHER WEATHER-RELATED CONDITIONS.**—For purposes **CONDI-**
TIONS.—

(1) *IN GENERAL.*—For purposes of this subtitle, the sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number the taxpayer would sell if he followed his usual business practices shall be treated as an involuntary conversion to which this section applies if such livestock are sold or exchanged by the taxpayer solely on account of drought, flood, or other weather-related conditions.

(2) *EXTENSION OF REPLACEMENT PERIOD.*—

(A) *IN GENERAL.*—In the case of drought, flood, or other weather-related conditions described in paragraph (1)

which result in the area being designated as eligible for assistance by the Federal Government, subsection (a)(2)(B) shall be applied with respect to any converted property by substituting “4 years” for “2 years”.

(B) FURTHER EXTENSION BY SECRETARY.—The Secretary may extend on a regional basis the period for replacement under this section (after the application of subparagraph (A)) for such additional time as the Secretary determines appropriate if the weather-related conditions which resulted in such application continue for more than 3 years.

* * * * *

Subchapter P—Capital Gains and Losses

* * * * *

PART I—TREATMENT OF CAPITAL GAINS

* * * * *

SEC. 1201. ALTERNATIVE TAX FOR CORPORATIONS.

(a) GENERAL RULE.—If for any taxable year a corporation has a net capital gain and any rate of tax imposed by section 11, 511, or 831(a) or (b) (whichever is applicable) exceeds 35 percent (determined without regard to [the last 2 sentences of section 11(b)(1)] *section 11(b)(5)*), then, in lieu of any such tax, there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) * * *

* * * * *

SEC. 1202. PARTIAL EXCLUSION FOR GAIN FROM CERTAIN SMALL BUSINESS STOCK.

(a) * * *

* * * * *

(e) ACTIVE BUSINESS REQUIREMENT.—

(1) * * *

* * * * *

(4) ELIGIBLE CORPORATION.—For purposes of this subsection, the term “eligible corporation” means any domestic corporation; except that such term shall not include—

(A) * * *

* * * * *

(C) a regulated investment company, real estate investment trust, [REMIC, or FASIT] *or REMIC*, and

* * * * *

PART II—TREATMENT OF CAPITAL LOSSES

* * * * *

SEC. 1212. CAPITAL LOSS CARRYBACKS AND CARRYOVERS.

(a) CORPORATIONS.—

(1) * * *

* * * * *

[(3) SPECIAL RULES ON CARRYBACKS.—A net capital loss of a corporation shall not be carried back under paragraph (1)(A) to a taxable year—

[(A) for which it is a foreign personal holding company (as defined in section 552);

[(B) for which it is a regulated investment company (as defined in section 851);

[(C) for which it is a real estate investment trust (as defined in section 856); or

[(D) for which an election made by it under section 1247 is applicable (relating to election by foreign investment companies to distribute income currently).]

(3) SPECIAL RULES ON CARRYBACKS.—A net capital loss of a corporation shall not be carried back under paragraph (1)(A) to a taxable year—

(A) for which it is a regulated investment company (as defined in section 851), or

(B) for which it is a real estate investment trust (as defined in section 856).

* * * * *

PART III—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

* * * * *

SEC. 1223. HOLDING PERIOD OF PROPERTY.

For purposes of this subtitle—

(1) * * *

* * * * *

[(10) In determining the period for which the taxpayer has held trust certificates of a trust to which subsection (d) of section 1246 applies, or the period for which the taxpayer has held stock in a corporation to which subsection (d) of section 1246 applies, there shall be included the period for which the trust or corporation (as the case may be) held the stock of foreign investment companies.]

[(11) (10) In the case of a person acquiring property from a decedent or to whom property passed from a decedent (within the meaning of section 1014(b)), if—

(A) * * *

* * * * *

[(12) (11) If—

(A) * * *

* * * * *

[(13) (12) In determining the period for which the taxpayer has held qualified replacement property (within the meaning of section 1042(b)) the acquisition of which resulted under section 1042 in the nonrecognition of any part of the gain realized on the sale of qualified securities (within the meaning of section 1042(b)), there shall be included the period

for which such qualified securities had been held by the taxpayer.

[(14)] (13) In determining the period for which the taxpayer has held property the acquisition of which resulted under section 1043 in the nonrecognition of any part of the gain realized on the sale of other property, there shall be included the period for which such other property had been held as of the date of such sale.

[(15)] (14) Except for purposes of sections 1202(a)(2), 1202(c)(2)(A), 1400B(b), and 1400F(b), in determining the period for which the taxpayer has held property the acquisition of which resulted under section 1045 or 1397B in the nonrecognition of any part of the gain realized on the sale of other property, there shall be included the period for which such other property has been held as of the date of such sale.

[(16)] (15) If the security to which a securities futures contract (as defined in section 1234B) relates (other than a contract to which section 1256 applies) is acquired in satisfaction of such contract, in determining the period for which the taxpayer has held such security, there shall be included the period for which the taxpayer held such contract if such contract was a capital asset in the hands of the taxpayer.

[(17)] (16) CROSS REFERENCE.—

For special holding period provision relating to certain partnership distributions, see section 735(b).

* * * * *

PART IV—SPECIAL RULES FOR DETERMINING CAPITALGAINS AND LOSSES

Sec. 1231.Property used in the trade or business and involuntary conversions.

* * * * *

[Sec. 1246.Gain on foreign investment company stock.

[Sec. 1247.Election by foreign investment companies to distribute income currently.]

* * * * *

[SEC. 1246. GAIN ON FOREIGN INVESTMENT COMPANY STOCK.

[(a) TREATMENT OF GAIN AS ORDINARY INCOME.—

[(1) GENERAL RULE.—In the case of a sale or exchange (or a distribution which, under section 302 or 331, is treated as an exchange of stock) after December 31, 1962, of stock in a foreign corporation which was a foreign investment company (as defined in subsection (b)) at any time during the period during which the taxpayer held such stock, any gain shall be treated as ordinary income, to the extent of the taxpayer's ratable share of the earnings and profits of such corporation accumulated for taxable years beginning after December 31, 1962.

[(2) RATABLE SHARE.—For purposes of this section, the taxpayer's ratable share shall be determined under regulations prescribed by the Secretary, but shall include only his ratable share of the accumulated earnings and profits of such corporation—

[(A) for the period during which the taxpayer held such stock, but

[(B) excluding such earnings and profits attributable to—

[(i) any amount previously included in the gross income of such taxpayer under section 951 (but only to the extent the inclusion of such amount did not result in an exclusion of any other amount from gross income under section 959), or

[(ii) any taxable year during which such corporation was not a foreign investment company but only if—

[(I) such corporation was not a foreign investment company at any time before such taxable year, and

[(II) such corporation was treated as a foreign investment company solely by reason of subsection (b)(2).

[(3) TAXPAYER TO ESTABLISH EARNINGS AND PROFITS.—Unless the taxpayer establishes the amount of the accumulated earnings and profits of the foreign investment company and the ratable share thereof for the period during which the taxpayer held such stock, all the gain from the sale or exchange of stock in such company shall be considered as ordinary income.

[(4) HOLDING PERIOD OF STOCK MUST BE MORE THAN 1 YEAR.—This section shall not apply with respect to the sale or exchange of stock where the holding period of such stock as of the date of such sale or exchange is 1 year or less.

[(b) DEFINITION OF FOREIGN INVESTMENT COMPANY.—For purposes of this section, the term “foreign investment company” means any foreign corporation which, for any taxable year beginning after December 31, 1962, is—

[(1) registered under the Investment Company Act of 1940, as amended (15 U.S.C. 80a-1 to 80b-2), either as a management company or as a unit investment trust, or

[(2) engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in—

[(A) securities (as defined in section 2(a)(36) of the Investment Company Act of 1940, as amended),

[(B) commodities, or

[(C) any interest (including a futures or forward contract or option) in property described in subparagraph (A) or (B),

at a time when 50 percent or more of the total combined voting power of all classes of stock entitled to vote, or the total value of all classes of stock, was held directly (or indirectly through applying paragraphs (2) and (3) of section 958(a) and paragraph (4) of section 318(a)) by United States persons (as defined in section 7701(a)(30)).

[(c) STOCK HAVING TRANSFERRED OR SUBSTITUTED BASIS.—To the extent provided in regulations prescribed by the Secretary, stock in a foreign corporation, the basis of which (in the hands of the taxpayer selling or exchanging such stock) is determined by ref-

erence to the basis (in the hands of such taxpayer or any other person) of stock in a foreign investment company, shall be treated as stock of a foreign investment company and held by the taxpayer throughout the holding period for such stock (determined under section 1223).

[(d) RULES RELATING TO ENTITIES HOLDING FOREIGN INVESTMENT COMPANY STOCK.—To the extent provided in regulations prescribed by the Secretary—

[(1) trust certificates of a trust to which section 677 (relating to income for benefit of grantor) applies, and

[(2) stock of a domestic corporation, shall be treated as stock of a foreign investment company and held by the taxpayer throughout the holding period for such certificates or stock (determined under section 1223) in the same proportion that the investment in stock in a foreign investment company by the trust or domestic corporation bears to the total assets of such trust or corporation.

[(e) RULES RELATING TO STOCK ACQUIRED FROM A DECEDENT.—

[(1) BASIS.—In the case of stock of a foreign investment company acquired by bequest, devise, or inheritance (or by the decedent's estate) from a decedent dying after December 31, 1962, the basis determined under section 1014 shall be reduced (but not below the adjusted basis of such stock in the hands of the decedent immediately before his death) by the amount of the decedent's ratable share of the earnings and profits of such company accumulated after December 31, 1962. Any stock so acquired shall be treated as stock described in subsection (c).

[(2) DEDUCTION FOR ESTATE TAX.—If stock to which subsection (a) applies is acquired from a decedent, the taxpayer shall, under regulations prescribed by the Secretary, be allowed (for the taxable year of the sale or exchange) a deduction from gross income equal to that portion of the decedent's estate tax deemed paid which is attributable to the excess of (A) the value at which such stock was taken into account for purposes of determining the value of the decedent's gross estate, over (B) the value at which it would have been so taken into account if such value had been reduced by the amount described in paragraph (1).

[(f) INFORMATION WITH RESPECT TO CERTAIN FOREIGN INVESTMENT COMPANIES.—Every United States person who, on the last day of the taxable year of a foreign investment company, owns 5 percent or more in value of the stock of such company shall furnish with respect to such company such information as the Secretary shall by regulations prescribe.

[(g) COORDINATION WITH SECTION 1248.—This section shall not apply to any gain to the extent such gain is treated as ordinary income under section 1248 (determined without regard to section 1248(g)(2)).

[(h) CROSS REFERENCE.—

For special rules relating to the earnings and profits of foreign investment companies, see section 312(j).

[SEC. 1247. ELECTION BY FOREIGN INVESTMENT COMPANIES TO DISTRIBUTE INCOME CURRENTLY.**[(a) ELECTION BY FOREIGN INVESTMENT COMPANY.—**

[(1) IN GENERAL.—If a foreign investment company which is described in section 1246(b)(1) elects (in the manner provided in regulations prescribed by the Secretary) on or before December 31, 1962, with respect to each taxable year beginning after December 31, 1962, to—

[(A) distribute to its shareholders 90 percent or more of what its taxable income would be if it were a domestic corporation;

[(B) designate in a written notice mailed to its shareholders at any time before the expiration of 45 days after the close of its taxable year the pro rata amount of the amount (determined as if such corporation were a domestic corporation) of the net capital gain of the taxable year; and the portion thereof which is being distributed; and

[(C) provide such information as the Secretary deems necessary to carry out the purposes of this section, then section 1246 shall not apply with respect to the qualified shareholders of such company during any taxable year to which such election applies.

[(2) SPECIAL RULES.—

[(A) COMPUTATION OF TAXABLE INCOME.—For purposes of paragraph (1)(A), the taxable income of the company shall be computed without regard to—

[(i) the net capital gain referred to in paragraph (1)(B),

[(ii) section 172 (relating to net operating losses), and

[(iii) any deduction provided by part VIII of subchapter B (other than the deduction provided by section 248, relating to organizational expenditures).

[(B) DISTRIBUTIONS AFTER THE CLOSE OF THE TAXABLE YEAR.—For purposes of paragraph (1)(A), a distribution made after the close of the taxable year and on or before the 15th day of the third month of the next taxable year shall be treated as distributed during the taxable year to the extent elected by the company (in accordance with regulations prescribed by the Secretary) on or before the 15th day of such third month.

[(C) CARRYOVER OF CAPITAL LOSSES FROM NONELECTION YEARS DENIED.—In computing the net capital gain referred to in paragraph (1)(B), section 1212 shall not apply to losses incurred in or with respect to taxable years before the first taxable year to which the election applies.

[(b) YEARS TO WHICH ELECTION APPLIES.—The election of any foreign investment company under this section shall terminate as of the close of the taxable year preceding its first taxable year in which any of the following occurs:

[(1) the company fails to comply with the provisions of subparagraph (A), (B), or

[(C) of subsection (a)(1), unless it is shown that such failure is due to reasonable cause and not due to willful neglect,

[(2) the company is a foreign personal holding company, or

[(3) the company is not a foreign investment company which is described in section 1246(b)(1).

[(c) QUALIFIED SHAREHOLDERS.—For purposes of this section—

[(1) IN GENERAL.—The term “qualified shareholder” means any shareholder who is a United States person (as defined in section 7701(a)(30)), other than a shareholder described in paragraph (2).

[(2) CERTAIN UNITED STATES PERSONS EXCLUDED FROM DEFINITION.—A United States person shall not be treated as a qualified shareholder for the taxable year if for such taxable year (or for any prior taxable year) he did not include, in computing his long-term capital gains in his return for such taxable year, the amount designated by such company pursuant to subsection (a)(1)(B) as his share of the undistributed capital gains of such company for its taxable year ending within or with such taxable year of the taxpayer. The preceding sentence shall not apply with respect to any failure by the taxpayer to treat an amount as provided therein if the taxpayer shows that such failure was due to reasonable cause and not due to willful neglect.

[(d) TREATMENT OF DISTRIBUTED AND UNDISTRIBUTED CAPITAL GAINS BY A QUALIFIED SHAREHOLDER.—Every qualified shareholder of a foreign investment company for any taxable year of such company with respect to which an election pursuant to subsection (a) is in effect shall include, in computing his long-term capital gains—

[(1) for his taxable year in which received, his pro rata share of the distributed portion of the net capital gain for such taxable year of such company, and

[(2) for his taxable year in which or with which the taxable year of such company ends, his pro rata share of the undistributed portion of the net capital gain for such taxable year of such company.

[(e) ADJUSTMENTS.—Under regulations prescribed by the Secretary, proper adjustment shall be made—

[(1) in the earnings and profits of the electing foreign investment company and a qualified shareholder’s ratable share thereof, and

[(2) in the adjusted basis of stock of such company held by such shareholder, to reflect such shareholder’s inclusion in gross income of undistributed capital gains.

[(f) ELECTION BY FOREIGN INVESTMENT COMPANY WITH RESPECT TO FOREIGN TAX CREDIT.—A foreign investment company with respect to which an election pursuant to subsection (a) is in effect and more than 50 percent of the value (as defined in section 851(c)(4)) of whose total assets at the close of the taxable year consists of stock or securities in foreign corporations may, for such taxable year, elect the application of this subsection with respect to income, war profits, and excess profits taxes described in section

901(b)(1) which are paid by the foreign investment company during such taxable year to foreign countries and possessions of the United States. If such election is made—

[(1) the foreign investment company—

[(A) shall compute its taxable income, for purposes of subsection (a)(1)(A), without any deductions for income, war profits, or excess profits taxes paid to foreign countries or possessions of the United States, and

[(B) shall treat the amount of such taxes, for purposes of subsection (a)(1)(A), as distributed to its shareholders;

[(2) each qualified shareholder of such foreign investment company—

[(A) shall include in gross income and treat as paid by him his proportionate share of such taxes, and

[(B) shall treat, for purposes of applying subpart A of part III of subchapter N, his proportionate share of such taxes as having been paid to the country in which the foreign investment company is incorporated, and

[(C) shall treat as gross income from sources within the country in which the foreign investment company is incorporated, for purposes of applying subpart A of part III of subchapter N, the sum of his proportionate share of such taxes and any dividend paid to him by such foreign investment company.

[(g) NOTICE TO SHAREHOLDERS.—The amounts to be treated by qualified shareholders, for purposes of subsection (f)(2), as their proportionate share of the taxes described in subsection (f)(1)(A) paid by a foreign investment company shall not exceed the amounts so designated by the foreign investment company in a written notice mailed to its shareholders not later than 45 days after the close of its taxable year.

[(h) MANNER OF MAKING ELECTION AND NOTIFYING SHAREHOLDERS.—The election provided in subsection (f) and the notice to shareholders required by subsection (g) shall be made in such manner as the Secretary may prescribe by regulations.

[(i) LOSS ON SALE OR EXCHANGE OF CERTAIN STOCK HELD LESS THAN 1 YEAR.—If—

[(1) under this section, any qualified shareholder treats any amount designated under subsection (a)(1)(B) with respect to a share of stock as long-term capital gain, and

[(2) such share is held by the taxpayer for less than 1 year, then any loss on the sale or exchange of such share shall, to the extent of the amount described in paragraph (1), be treated as loss from the sale or exchange of a capital asset held for more than 1 year.]

* * * * *

SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.

(a) * * *

* * * * *

(d) EXCLUSIONS FROM EARNINGS AND PROFITS.—For purposes of this section, the following amounts shall be excluded, with respect

to any United States person, from the earnings and profits of a foreign corporation:

(1) * * *

* * * * *

[(5) AMOUNTS INCLUDED IN GROSS INCOME UNDER SECTION 1247.—If the United States person whose stock is sold or exchanged was a qualified shareholder (as defined in section 1247(c)) of a foreign corporation which was a foreign investment company (as described in section 1246(b)(1)), the earnings and profits of the foreign corporation for taxable years in which such person was a qualified shareholder.]

[(6)] (5) FOREIGN TRADE INCOME.—Earnings and profits of the foreign corporation attributable to foreign trade income of a FSC other than foreign trade income which—

(A) * * *

* * * * *

[(7)] (6) AMOUNTS INCLUDED IN GROSS INCOME UNDER SECTION 1293.—Earnings and profits of the foreign corporation attributable to any amount previously included in the gross income of such person under section 1293 with respect to the stock sold or exchanged, but only to the extent the inclusion of such amount did not result in an exclusion of an amount under section 1293(c).

* * * * *

SEC. 1260. GAINS FROM CONSTRUCTIVE OWNERSHIP TRANSACTIONS.

(a) * * *

* * * * *

(c) FINANCIAL ASSET.—For purposes of this section—

(1) * * *

(2) PASS-THRU ENTITY.—For purposes of paragraph (1), the term “pass-thru entity” means—

(A) * * *

* * * * *

[(H) a foreign personal holding company,

[(I) a foreign investment company (as defined in section 1246(b)), and]

[(J)] (H) a REMIC.

* * * * *

PART V—SPECIAL RULES FOR BONDS AND OTHER DEBT INSTRUMENTS

* * * * *

Subpart A—Original Issue Discount

* * * * *

SEC. 1272. CURRENT INCLUSION IN INCOME OF ORIGINAL ISSUE DISCOUNT.

(a) ORIGINAL ISSUE DISCOUNT ON DEBT INSTRUMENTS ISSUED AFTER JULY 1, 1982, INCLUDED IN INCOME ON BASIS OF CONSTANT INTEREST RATE.—

(1) * * *

* * * * *

(6) DETERMINATION OF DAILY PORTIONS WHERE PRINCIPAL
SUBJECT TO ACCELERATION.—

(A) * * *

(B) DETERMINATION OF PRESENT VALUE.—For purposes
of subparagraph (A), the present value shall be determined
on the basis of—

(i) * * *

* * * * *

*For purposes of clause (iii), the Secretary shall prescribe
regulations permitting the use of a current prepayment as-
sumption, determined as of the close of the accrual period
(or such other time as the Secretary may prescribe during
the taxable year in which the accrual period ends).*

* * * * *

**SEC. 1274. DETERMINATION OF ISSUE PRICE IN THE CASE OF CER-
TAIN DEBT INSTRUMENTS ISSUED FOR PROPERTY.**

(a) * * *

(b) IMPUTED PRINCIPAL AMOUNT.—For purposes of this
section—

(1) * * *

* * * * *

(3) FAIR MARKET VALUE RULE IN POTENTIALLY ABUSIVE SIT-
UATIONS.—

(A) * * *

(B) POTENTIALLY ABUSIVE SITUATION DEFINED.—For
purposes of subparagraph (A), the term “potentially abu-
sive situation” means—

(i) a tax shelter (as defined in [section
6662(d)(2)(C)(iii)] *section 6662(d)(2)(C)(ii)*), and

* * * * *

Subpart D—Miscellaneous Provisions

* * * * *

SEC. 1286. TAX TREATMENT OF STRIPPED BONDS.

(a) * * *

* * * * *

(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this
section—

(1) * * *

* * * * *

(7) CROSS REFERENCE.—

*For treatment of stripped interests in certain accounts or entities
holding preferred stock, see section 1286(f).*

* * * * *

(f) TREATMENT OF STRIPPED INTERESTS IN BOND AND PRE-
FERRED STOCK FUNDS, ETC.—In the case of an account or entity
substantially all of the assets of which consist of bonds, preferred

stock, or a combination thereof, the Secretary may by regulations provide that rules similar to the rules of this section and 305(e), as appropriate, shall apply to interests in such account or entity to which (but for this subsection) this section or section 305(e), as the case may be, would not apply.

[(f)] (g) REGULATION AUTHORITY.—The Secretary may prescribe regulations providing that where, by reason of varying rates of interest, put or call options, or other circumstances, the tax treatment under this section does not accurately reflect the income of the holder of a stripped coupon or stripped bond, or of the person disposing of such bond or coupon, as the case may be, for any period, such treatment shall be modified to require that the proper amount of income be included for such period.

* * * * *

PART VI—TREATMENT OF CERTAIN PASSIVE FOREIGN INVESTMENT COMPANIES

* * * * *

Subpart A—Interest on Tax Deferral

* * * * *

SEC. 1291. INTEREST ON TAX DEFERRAL.

(a) * * *

* * * * *

(b) EXCESS DISTRIBUTION.—

(1) * * *

* * * * *

(3) ADJUSTMENTS.—Under regulations prescribed by the Secretary—

(A) * * *

* * * * *

(F) proper adjustment shall be made for amounts not includible in gross income by reason of section 551(d), 959(a), 959(a) or 1293(c), and

* * * * *

(e) Certain basis, etc., rules made applicableExcept to the extent inconsistent with the regulations prescribed under subsection (f), rules similar to the rules of subsections (c), (d), (e), and (f) of section 1246 (*as in effect on the day before the date of the enactment of the American Jobs Creation Act of 2003*) shall apply for purposes of this section; except that—

(1) * * *

* * * * *

Subpart B—Treatment of Qualified Electing Funds

* * * * *

SEC. 1294. ELECTION TO EXTEND TIME FOR PAYMENT OF TAX ON UN-DISTRIBUTED EARNINGS.

(a) EXTENSION ALLOWED BY ELECTION.—

(1) * * *

[(2) ELECTION NOT PERMITTED WHERE AMOUNTS OTHERWISE INCLUDIBLE UNDER SECTION 551 OR 951.—The taxpayer may not make an election under paragraph (1) with respect to the undistributed PFIC earnings tax liability attributable to a qualified electing fund for the taxable year if—

[(A) any amount is includible in the gross income of the taxpayer under section 551 with respect to such fund for such taxable year, or

[(B) any amount is includible in the gross income of the taxpayer under section 951 with respect to such fund for such taxable year.]

(2) *ELECTION NOT PERMITTED WHERE AMOUNTS OTHERWISE INCLUDIBLE UNDER SECTION 951.—The taxpayer may not make an election under paragraph (1) with respect to the undistributed PFIC earnings tax liability attributable to a qualified electing fund for the taxable year if any amount is includible in the gross income of the taxpayer under section 951 with respect to such fund for such taxable year.*

* * * * *

Subchapter S—Tax Treatment of S Corporations and Their Shareholders

* * * * *

PART I—IN GENERAL

* * * * *

SEC. 1361. S CORPORATION DEFINED

(a) * * *

(b) SMALL BUSINESS CORPORATION.—

(1) IN GENERAL.—For purposes of this subchapter, the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not—

(A) have more than [75] 100 shareholders,

* * * * *

(3) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.—

(A) IN GENERAL.—Except as provided in regulations prescribed by the Secretary *and in the case of information returns required under part III of subchapter A of chapter 61*, for purposes of this title—

(i) * * *

* * * * *

(c) SPECIAL RULES FOR APPLYING SUBSECTION (B).—

[(1) HUSBAND AND WIFE TREATED AS 1 SHAREHOLDER.—For purposes of subsection (b)(1)(A), a husband and wife (and their estates) shall be treated as 1 shareholder.]

(1) *MEMBERS OF FAMILY TREATED AS 1 SHAREHOLDER.—*

(A) *IN GENERAL.—For purpose of subsection (b)(1)(A)—*

i) except as provided in clause (ii), a husband and wife (and their estates) shall be treated as 1 shareholder, and

(ii) in the case of a family with respect to which an election is in effect under subparagraph (D), all members of the family shall be treated as 1 shareholder.

(B) MEMBERS OF THE FAMILY.—For purpose of subparagraph (A)(ii)—

(i) IN GENERAL.—The term “members of the family” means the common ancestor, lineal descendants of the common ancestor, and the spouses (or former spouses) of such lineal descendants or common ancestor.

(ii) COMMON ANCESTOR.—For purposes of this paragraph, an individual shall not be considered a common ancestor if, as of the later of the effective date of this paragraph or the time the election under section 1362(a) is made, the individual is more than 3 generations removed from the youngest generation of shareholders who would (but for this clause) be members of the family. For purposes of the preceding sentence, a spouse (or former spouse) shall be treated as being of the same generation as the individual to which such spouse is (or was) married.

(C) EFFECT OF ADOPTION, ETC.—In determining whether any relationship specified in subparagraph (B) exists, the rules of section 152(b)(2) shall apply.

(D) ELECTION.—An election under subparagraph (A)(ii)—

(i) may, except as otherwise provided in regulations prescribed by the Secretary, be made by any member of the family, and

(ii) shall remain in effect until terminated as provided in regulations prescribed by the Secretary.

(2) CERTAIN TRUSTS PERMITTED AS SHAREHOLDERS.—

(A) IN GENERAL.—For purposes of subsection (b)(1)(B), the following trusts may be shareholders:

*(i) * * **

** * * * **

(vi) In the case of a corporation which is a bank (as defined in section 581), a trust which constitutes an individual retirement account under section 408(a), including one designated as a Roth IRA under section 408A, but only to the extent of the stock held by such trust in such bank as of the date of the enactment of this clause.

** * * * **

(B) TREATMENT AS SHAREHOLDERS.—For purposes of subsection (b)(1)—

*(i) * * **

** * * * **

(vi) In the case of a trust described in clause (vi) of subparagraph (A), the individual for whose benefit the trust was created shall be treated as a shareholder.

(d) SPECIAL RULE FOR QUALIFIED SUBCHAPTER S TRUST.—

(1) IN GENERAL.—In the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under paragraph (2)—

(A) such trust shall be treated as a trust described in subsection (c)(2)(A)(i), **and**

(B) for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under paragraph (2) is made**and**, and

(C) for purposes of applying sections 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

* * * * *

(e) ELECTING SMALL BUSINESS TRUST DEFINED.—

(1) * * *

(2) POTENTIAL CURRENT BENEFICIARY.—For purposes of this section, the term “potential current beneficiary” means, with respect to any period, any person who at any time during such period is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust *(determined without regard to any power of appointment to the extent such power remains unexercised at the end of such period)*. If a trust disposes of all of the stock which it holds in an S corporation, then, with respect to such corporation, the term “potential current beneficiary” does not include any person who first met the requirements of the preceding sentence during the **60-day** 1-year period ending on the date of such disposition.

(f) RESTRICTED BANK DIRECTOR STOCK.—

(1) IN GENERAL.—Restricted bank director stock shall not be taken into account as outstanding stock of the S corporation in applying this subchapter *(other than section 1368(f))*.

(2) RESTRICTED BANK DIRECTOR STOCK.—For purposes of this subsection, the term “restricted bank director stock” means stock in a bank (as defined in section 581), a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a))), or a financial holding company (within the meaning of section 2(p) of such Act), registered with the Federal Reserve System if such stock—

(A) is required to be held by an individual under applicable Federal or State law in order to permit such individual to serve as a director, and

(B) is subject to an agreement with such bank or company (or a corporation which controls (within the meaning of section 368(c)) such bank or company) pursuant to which the holder is required to sell back such stock (at the same price as the individual acquired such stock) upon ceasing to hold the office of director.

(3) CROSS REFERENCE.—

For treatment of certain distributions with respect to restricted bank director stock, see section 1368(f).

* * * * *

SEC. 1362. ELECTION; REVOCATION; TERMINATION.

(a) * * *

* * * * *

(d) TERMINATION.—

(1) * * *

* * * * *

(3) WHERE PASSIVE INVESTMENT INCOME EXCEEDS 25 PERCENT OF GROSS RECEIPTS FOR 3 CONSECUTIVE TAXABLE YEARS AND CORPORATION HAS ACCUMULATED EARNINGS AND PROFITS.—

(A) * * *

* * * * *

(F) EXCEPTION FOR BANKS; ETC.—In the case of a bank (as defined in section 581), a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)), or a financial holding company (within the meaning of section 2(p) of such Act), the term “passive investment income” shall not include—

(i) interest income earned by such bank or company, or

(ii) dividends on assets required to be held by such bank or company, including stock in the Federal Reserve Bank, the Federal Home Loan Bank, or the Federal Agricultural Mortgage Bank or participation certificates issued by a Federal Intermediate Credit Bank.

* * * * *

(f) INADVERTENT INVALID ELECTIONS OR TERMINATIONS.—If—

(1) an election under subsection (a), section 1361(b)(3)(B)(ii), or section 1361(c)(1)(A)(ii) by any corporation—

(A) was not effective for the taxable year for which made (determined without regard to subsection (b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or

(B) was terminated under paragraph (2) or (3) of subsection (d), section 1361(b)(3)(C), or section 1361(c)(1)(D)(iii),

* * * * *

(3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken—

[(A) so that the corporation is a small business corporation, or]

(A) so that the corporation for which the election was made is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or

* * * * *

[(4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,]

(4) the corporation for which the election was made, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) as may be required by the Secretary with respect to such period,

then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation or a qualified subchapter S subsidiary, as the case may be during the period specified by the Secretary.

* * * * *

PART II—TAX TREATMENT OF SHAREHOLDERS

* * * * *

SEC. 1366. PASS-THRU OF ITEMS TO SHAREHOLDERS.

(a) Determination of shareholder's tax liability

(1) * * *

* * * * *

(d) Special rules for losses and deductions

(1) * * *

[(2) Indefinite carryover of disallowed losses and deductions Any loss or deduction which is disallowed for any taxable year by reason of paragraph (1) shall be treated as incurred by the corporation in the succeeding taxable year with respect to that shareholder.]

(2) INDEFINITE CARRYOVER OF DISALLOWED LOSSES AND DEDUCTIONS.—

(A) IN GENERAL.—*Except as provided in subparagraph (B), any loss or deduction which is disallowed for any taxable year by reason of paragraph (1) shall be treated as incurred by the corporation in the succeeding taxable year with respect to that shareholder.*

(B) TRANSFERS OF STOCK BETWEEN SPOUSES OR INCIDENT TO DIVORCE.—*In the case of any transfer described in section 1041(a) of stock of an S corporation, any loss or deduction described in subparagraph (A) with respect such stock shall be treated as incurred by the corporation in the succeeding taxable year with respect to the transferee.*

SEC. 1368. DISTRIBUTIONS.

(a) * * *

* * * * *

(f) *RESTRICTED BANK DIRECTOR STOCK.*—If a director receives a distribution (not in part or full payment in exchange for stock) from an S corporation with respect to any restricted bank director stock (as defined in section 1361(f)), the amount of such distribution—

- (1) shall be includible in gross income of the director, and
 (2) shall be deductible by the corporation for the taxable year of such corporation in which or with which ends the taxable year in which such amount is included in the gross income of the director.

* * * * *

Subchapter T—Cooperatives and Their Patrons

* * * * *

PART III—DEFINITIONS; SPECIAL RULES

* * * * *

SEC. 1388. DEFINITIONS; SPECIAL RULES.

(a) *PATRONAGE DIVIDEND.*—For purposes of this subchapter, the term “patronage dividend” means an amount paid to a patron by an organization to which part I of this subchapter applies—

(1) * * *

* * * * *

Such term does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions. *For purposes of paragraph (3), net earnings shall not be reduced by amounts paid during the year as dividends on capital stock or other proprietary capital interests of the organization to the extent that the articles of incorporation or bylaws of such organization or other contract with patrons provide that such dividends are in addition to amounts otherwise payable to patrons which are derived from business done with or for patrons during the taxable year.*

* * * * *

CHAPTER 3—WITHHOLDING OF TAX ON NON-RESIDENT ALIENS AND FOREIGN CORPORATIONS

* * * * *

Subchapter A—Nonresident Aliens and Foreign Corporations

* * * * *

SEC. 1441. WITHHOLDING OF TAX ON NONRESIDENT ALIENS.

(a) * * *

* * * * *

(c) EXCEPTIONS.—

(1) * * *

* * * * *

(12) CERTAIN DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANIES.—

(A) IN GENERAL.—No tax shall be required to be deducted and withheld under subsection (a) from any amount exempt from the tax imposed by section 871(a)(1)(A) by reason of section 871(k).

(B) SPECIAL RULE.—For purposes of subparagraph (A), clause (i) of section 871(k)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause. A similar rule shall apply with respect to the exception contained in section 871(k)(2)(B).

* * * * *

SEC. 1442. WITHHOLDING OF TAX ON FOREIGN CORPORATIONS.

(a) GENERAL RULE.—In the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 a tax equal to 30 percent thereof. For purposes of the preceding sentence, the references in section 1441(b) to sections 871(a)(1)(C) and (D) shall be treated as referring to sections 881(a)(3) and (4), the reference in section 1441(c)(1) to section 871(b)(2) shall be treated as referring to section 842 or section 882(a)(2), as the case may be, the reference in section 1441(c)(5) to section 871(a)(1)(D) shall be treated as referring to section 881(a)(4), the reference in section 1441(c)(8) to section 871(a)(1)(C) shall be treated as referring to section 881(a)(3), the references in section 1441(c)(9) to sections 871(h) and 871(h)(3) or (4) shall be treated as referring to sections 881(c) and 881(c)(3) or (4), [and the reference in section 1441(c)(10)] *the reference in section 1441(c)(10) to section 871(i)(2) shall be treated as referring to section 881(d), and the references in section 1441(c)(12) to sections 871(a) and 871(k) shall be treated as referring to sections 881(a) and 881(e) (except that for purposes of applying subparagraph (A) of section 1441(c)(12), as so modified, clause (ii) of section 881(e)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause).*

* * * * *

CHAPTER 6—CONSOLIDATED RETURNS

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Subchapter B—Related Rules

* * * * *

PART II—CERTAIN CONTROLLED CORPORATIONS

* * * * *

SEC. 1561. LIMITATIONS ON CERTAIN MULTIPLE TAX BENEFITS IN THE CASE OF CERTAIN CONTROLLED CORPORATIONS.

(a) **GENERAL RULE.**—The component members of a controlled group of corporations on a December 31 shall, for their taxable years which include such December 31, be limited for purposes of this subtitle to—

(1) * * *

* * * * *

The amounts specified in paragraph (1), the amount specified in paragraph (3), and the amount specified in paragraph (4) shall be divided equally among the component members of such group on such December 31 unless all of such component members consent (at such time and in such manner as the Secretary shall by regulations prescribe) to an apportionment plan providing for an unequal allocation of such amounts. The amounts specified in paragraph (2) shall be divided equally among the component members of such group on such December 31 unless the Secretary prescribes regulations permitting an unequal allocation of such amounts. Notwithstanding paragraph (1), in applying [the last 2 sentences of section 11(b)(1)] *section 11(b)(5)* to such component members, the taxable income of all such component members shall be taken into account and any increase in tax under [such last 2 sentences] *section 11(b)(5)* shall be divided among such component members in the same manner as amounts under paragraph (1). In applying section 55(d)(3), the alternative minimum taxable income of all component members shall be taken into account and any decrease in the exemption amount shall be allocated to the component members in the same manner as under paragraph (3).

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Subtitle B—Estate and Gift Taxes

* * * * *

CHAPTER 11—ESTATE TAX

* * * * *

Subchapter B—Estates of Nonresidents Not Citizens

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SEC. 2105. PROPERTY WITHOUT THE UNITED STATES.

(a) * * *

* * * * *

(d) *STOCK IN A RIC.*—

(1) *IN GENERAL.*—For purposes of this subchapter, stock in a regulated investment company (as defined in section 851) owned by a nonresident not a citizen of the United States shall not be deemed property within the United States in the proportion that, at the end of the quarter of such investment company's taxable year immediately preceding a decedent's date of death (or at such other time as the Secretary may designate in regulations), the assets of the investment company that were qualifying assets with respect to the decedent bore to the total assets of the investment company.

(2) *QUALIFYING ASSETS.*—For purposes of this subsection, qualifying assets with respect to a decedent are assets that, if owned directly by the decedent, would have been—

(A) amounts, deposits, or debt obligations described in subsection (b) of this section,

(B) debt obligations described in the last sentence of section 2104(c), or

(C) other property not within the United States.

* * * * *

SEC. 2107. EXPATRIATION TO AVOID TAX

[(a) TREATMENT OF EXPATRIATES.—

[(1) *RATE OF TAX.*—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United States if, within the 10-year period ending with the date of death, such decedent lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A—

[(2) *CERTAIN INDIVIDUALS TREATED AS HAVING TAX AVOIDANCE PURPOSE.*—

[(A) *IN GENERAL.*—For purposes of paragraph (1), an individual shall be treated as having a principal purpose to avoid such taxes if such individual is so treated under section 877(a)(2).

[(B) *EXCEPTION.*—Subparagraph (A) shall not apply to a decedent meeting the requirements of section 877(c)(1).]

(a) *TREATMENT OF EXPATRIATES.*—A tax computed in accordance with the table contained in section 2001 is hereby imposed on the transfer of the taxable estate, determined as provided in section 2106, of every decedent nonresident not a citizen of the United

States if the date of death occurs during a taxable year with respect to which the decedent is subject to tax under section 877(b).

* * * * *

CHAPTER 12—GIFT TAX

* * * * *

Subchapter A—Determination of Tax Liability

* * * * *

SEC. 2501. IMPOSITION OF TAX.

(a) TAXABLE TRANSFERS.—

(1) * * *

* * * * *

[(3) EXCEPTION.—

[(A) CERTAIN INDIVIDUALS.—Paragraph (2) shall not apply in the case of a donor who, within the 10-year period ending with the date of transfer, lost United States citizenship, unless such loss did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A.

[(B) CERTAIN INDIVIDUALS TREATED AS HAVING TAX AVOIDANCE PURPOSE.—For purposes of subparagraph (A), an individual shall be treated as having a principal purpose to avoid such taxes if such individual is so treated under section 877(a)(2).

[(C) EXCEPTION FOR CERTAIN INDIVIDUALS.—Subparagraph (B) shall not apply to a donor meeting the requirements of section 877(c)(1).

[(D) CREDIT FOR FOREIGN GIFT TAXES.—The tax imposed by this section solely by reason of this paragraph shall be credited with the amount of any gift tax actually paid to any foreign country in respect of any gift which is taxable under this section solely by reason of this paragraph.

[(E) CROSS REFERENCE.—

[For comparable treatment of long-term lawful permanent residents who ceased to be taxed as residents, see section 877(e).

[(4) BURDEN OF PROOF.—If the Secretary establishes that it is reasonable to believe that an individual's loss of United States citizenship would, but for paragraph (3), result in a substantial reduction for the calendar year in the taxes on the transfer of property by gift, the burden of proving that such loss of citizenship did not have for one of its principal purposes the avoidance of taxes under this subtitle or subtitle A shall be on such individual.]

(3) EXCEPTION.—

(A) CERTAIN INDIVIDUALS.—Paragraph (2) shall not apply in the case of a donor to whom section 877(b) applies for the taxable year which includes the date of the transfer.

(B) CREDIT FOR FOREIGN GIFT TAXES.—The tax imposed by this section solely by reason of this paragraph

shall be credited with the amount of any gift tax actually paid to any foreign country in respect of any gift which is taxable under this section solely by reason of this paragraph.

[(5)] (4) TRANSFERS TO POLITICAL ORGANIZATIONS.—Paragraph (1) shall not apply to the transfer of money or other property to a political organization (within the meaning of section 527(e)(1)) for the use of such organization.

(5) TRANSFERS OF CERTAIN STOCK.—

(A) IN GENERAL.—*In the case of a transfer of stock in a foreign corporation described in subparagraph (B) by a donor to whom section 877(b) applies for the taxable year which includes the date of the transfer—*

(i) section 2511(a) shall be applied without regard to whether such stock is situated within the United States, and

(ii) the value of such stock for purposes of this chapter shall be its U.S.-asset value determined under subparagraph (C).

(B) FOREIGN CORPORATION DESCRIBED.—*A foreign corporation is described in this subparagraph with respect to a donor if—*

(i) the donor owned (within the meaning of section 958(a)) at the time of such transfer 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation, and

(ii) such donor owned (within the meaning of section 958(a)), or is considered to have owned (by applying the ownership rules of section 958(b)), at the time of such transfer, more than 50 percent of—

(I) the total combined voting power of all classes of stock entitled to vote of such corporation, or

(II) the total value of the stock of such corporation.

(C) U.S.-ASSET VALUE.—*For purposes of subparagraph (A), the U.S.-asset value of stock shall be the amount which bears the same ratio to the fair market value of such stock at the time of transfer as—*

(i) the fair market value (at such time) of the assets owned by such foreign corporation and situated in the United States, bears to

(ii) the total fair market value (at such time) of all assets owned by such foreign corporation.

* * * * *

Subtitle C—Employment Taxes

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CHAPTER 21—FEDERAL INSURANCE CONTRIBUTIONS ACT

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Subchapter C—General Provisions

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SEC. 3121. DEFINITIONS.

(a) **WAGES.**—For purposes of this chapter, the term “wages” means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) * * *

* * * * *

(20) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 117, or 132; **or**

(21) in the case of a member of an Indian tribe, any remuneration on which no tax is imposed by this chapter by reason of section 7873 (relating to income derived by Indians from exercise of fishing rights) **or**; **or**

(22) *remuneration on account of—*

(A) *a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option (as defined in section 422(b)) or under an employee stock purchase plan (as defined in section 423(b)), or*

(B) *any disposition by the individual of such stock.*

* * * * *

(v) **TREATMENT OF CERTAIN DEFERRED COMPENSATION AND SALARY REDUCTION ARRANGEMENTS.**—

(1) * * *

(2) **TREATMENT OF CERTAIN NONQUALIFIED DEFERRED COMPENSATION PLANS.**—

(A) **IN GENERAL.**—Any amount deferred under a non-qualified deferred compensation plan shall be taken into account for purposes of this chapter as of the later of—

(i) when the services are performed, or

(ii) when there is no substantial risk of forfeiture of the rights to such amount.

The preceding sentence shall not apply to any excess parachute payment (as defined in section 280G(b)) *or to any specified stock compensation (as defined in section 4985) on which tax is imposed by section 4985.*

* * * * *

CHAPTER 22—RAILROAD RETIREMENT TAX ACT

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Subchapter D—General Provisions

* * * * *

SEC. 3231. DEFINITIONS.

(a) * * *

* * * * *

(e) COMPENSATION.—For purposes of this chapter—

(1) * * *

* * * * *

(11) *QUALIFIED STOCK OPTIONS.*—The term “compensation” shall not include any remuneration on account of—

(A) a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option (as defined in section 422(b)) or under an employee stock purchase plan (as defined in section 423(b)), or

(B) any disposition by the individual of such stock.

* * * * *

CHAPTER 23—FEDERAL UNEMPLOYMENT TAX ACT

* * * * *

SEC. 3306. DEFINITIONS.

(a) * * *

(b) *WAGES.*—For purposes of this chapter, the term “wages” means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) * * *

* * * * *

(16) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 117, or 132; **[or]**

(17) any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(b)**[.]**; or

(18) remuneration on account of—

(A) a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option (as defined in section 422(b)) or under an employee stock purchase plan (as defined in section 423(b)), or

(B) any disposition by the individual of such stock.

* * * * *

Subtitle D—Miscellaneous Excise Taxes

Chapter 31. Retail excise taxes.

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Chapter 45. Provisions relating to expatriated entities.

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CHAPTER 32—MANUFACTURERS EXCISE TAXES

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Subchapter C—Certain Vaccines

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SEC. 4132. DEFINITIONS AND SPECIAL RULES.

(a) DEFINITIONS RELATING TO TAXABLE VACCINES.—For purposes of this subchapter—

(1) TAXABLE VACCINE.—The term “taxable vaccine” means any of the following vaccines which are manufactured or produced in the United States or entered into the United States for consumption, use, or warehousing:

(A) * * *

* * * * *

(I) Any vaccine against hepatitis A.

[(I)] (J) ANY VACCINE AGAINST HEPATITIS B.

[(J)] (K) ANY VACCINE AGAINST CHICKEN POX.

[(K)] (L) ANY VACCINE AGAINST ROTAVIRUS GASTROENTERITIS.

[(L)] (M) ANY CONJUGATE VACCINE AGAINST STREPTOCOCCUS PNEUMONIAE.

* * * * *

Subchapter D—Recreational Equipment

* * * * *

PART I—SPORTING GOODS

* * * * *

SEC. 4161. IMPOSITION OF TAX.

(a) * * *

(b) BOWS AND ARROWS, ETC.—

[(1) BOWS.—

[(A) IN GENERAL.—There is hereby imposed on the sale by the manufacturer, producer, or importer of any bow which has a draw weight of 10 pounds or more, a tax equal to 11 percent of the price for which so sold.

[(B) PARTS AND ACCESSORIES.—There is hereby imposed upon the sale by the manufacturer, producer, or importer—

[(i) of any part of accessory suitable for inclusion in or attachment to a bow described in subparagraph (A), and

[(ii) of any quiver suitable for use with arrows described in paragraph (2), a tax equivalent to 11 percent of the price for which so sold.]

(1) *BOWS.*—

(A) *IN GENERAL.*—*There is hereby imposed on the sale by the manufacturer, producer, or importer of any bow which has a peak draw weight of 30 pounds or more, a tax equal to 11 percent of the price for which so sold.*

(B) *ARCHERY EQUIPMENT.*—*There is hereby imposed on the sale by the manufacturer, producer, or importer—*

(i) of any part or accessory suitable for inclusion in or attachment to a bow described in subparagraph (A), and

(ii) of any quiver or broadhead suitable for use with an arrow described in paragraph (3),

a tax equal to 11 percent of the price for which so sold.

(2) **[ARROWS.—]** *ARROW COMPONENTS.*—*There is hereby imposed on the sale by the manufacturer, producer, or importer of any shaft, point (other than a broadhead),nock, or vane of a type used in the manufacture of any arrow which after its assembly—*

(A) * * *

* * * * *

(3) *ARROWS.*—

(A) *IN GENERAL.*—*There is hereby imposed on the sale by the manufacturer, producer, or importer of any arrow, a tax equal to 12 percent of the price for which so sold.*

(B) *EXCEPTION.*—*The tax imposed by subparagraph (A) on an arrow shall not apply if the arrow contains an arrow shaft with respect to which tax was paid under paragraph (2).*

(C) *ARROW.*—*For purposes of this paragraph, the term “arrow” means any shaft described in paragraph (2) to which additional components are attached.*

[(3)] (4) *COORDINATION WITH SUBSECTION (A).*—*No tax shall be imposed under this subsection with respect to any article taxable under subsection (a).*

* * * * *

SEC. 4162. DEFINITIONS; TREATMENT OF CERTAIN REALES.

(a) **SPORT FISHING EQUIPMENT DEFINED.**—*For purposes of this part, the term “sport fishing equipment” means—*

(1) * * *

* * * * *

(6) *the following items of fishing supplies and accessories—*

(A) * * *

* * * * *

[(C) tackle boxes,]

- [(D)] (C) bags, baskets, and other containers designed to hold fish,
 [(E)] (D) portable bait containers,
 [(F)] (E) fishing vests,
 [(G)] (F) landing nets,
 [(H)] (G) gaff hooks,
 [(I)] (H) fishing hook disgorgers, and
 [(J)] (I) dressing for fishing lines and artificial flies,
 * * * * *
 (8) fishing rod belts, fishing rodholders, fishing harnesses, fish fighting chairs, fishing outriggers, and fishing downriggers, *and*
 (9) electric outboard boat motors[, and].
 [(10) sonar devices suitable for finding fish.]
 [(b) SONAR DEVICE SUITABLE FOR FINDING FISH.—For purposes of this part, the term “sonar device suitable for finding fish” shall not include any sonar device which is—
 [(1) a graph recorder,
 [(2) a digital type,
 [(3) a meter readout, or
 [(4) a combination graph recorder or combination meter readout.]
 [(c)] (b) TREATMENT OF CERTAIN REALES.—
 (1) * * *
 * * * * *

CHAPTER 42—PRIVATE FOUNDATIONS AND CERTAIN OTHER TAX-EXEMPT ORGANIZATIONS

* * * * *

Subchapter A—Private Foundations

* * * * *

SEC. 4947. APPLICATION OF TAXES TO CERTAIN NONEXEMPT TRUSTS.

(a) APPLICATION OF TAX.—

(1) CHARITABLE TRUSTS.—For purposes of part II of subchapter F of chapter 1 (other than section 508(a), (b), and (c)) and for purposes of this chapter, a trust which is not exempt from taxation under section 501(a), all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and for which a deduction was allowed under section 170, 545(b)(2), [556(b)(2),] 642(c), 2055, 2106(a)(2), or 2522 (or the corresponding provisions of prior law), shall be treated as an organization described in section 501(c)(3). For purposes of section 509(a)(3)(A), such a trust shall be treated as if organized on the day on which it first becomes subject to this paragraph.

(2) SPLIT-INTEREST TRUSTS.—In the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests in which are devoted to one or more of the

purposes described in section 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under section 170, 545(b)(2), [556(b)(2), 642(c),] 2055, 2106(a)(2), or 2522, section 507 (relating to termination of private foundation status), section 508(e) (relating to governing instruments) to the extent applicable to a trust described in this paragraph, section 4941 (relating to taxes on self-dealing), section 4943 (relating to taxes on excess business holdings) except as provided in subsection (b)(3), section 4944 (relating to investments which jeopardize charitable purpose) except as provided in subsection (b)(3), and section 4945 (relating to taxes on taxable expenditures) shall apply as if such trust were a private foundation. This paragraph shall not apply with respect to—

(A) * * *

(B) any amounts in trust other than amounts for which a deduction was allowed under section 170, 545(b)(2), [556(b)(2),] 642(c), 2055, 2106(a)(2), or 2522, if such other amounts are segregated from amounts for which no deduction was allowable, or

* * * * *

(b) SPECIAL RULES.—

(1) * * *

* * * * *

(3) SECTIONS 4943 AND 4944.—Sections 4943 and 4944 shall not apply to a trust which is described in subsection (a)(2) if—

(A) all the income interest (and none of the remainder interest) of such trust is devoted solely to one or more of the purposes described in section 170(c)(2)(B), and all amounts in such trust for which a deduction was allowed under section 170, 545(b)(2), [556(b)(2),] 642(c), 2055, 2106(a)(2), or 2522 have an aggregate value not more than 60 percent of the aggregate fair market value of all amounts in such trusts, or

(B) a deduction was allowed under section 170, 545(b)(2), [556(b)(2),] 642(c), 2055, 2106(a)(2), or 2522 for amounts payable under the terms of such trust to every remainder beneficiary but not to any income beneficiary.

* * * * *

SEC. 4948. APPLICATION OF TAXES AND DENIAL OF EXEMPTION WITH RESPECT TO CERTAIN FOREIGN ORGANIZATIONS.

(a) * * *

* * * * *

(c) DENIAL OF EXEMPTION TO FOREIGN ORGANIZATIONS ENGAGED IN PROHIBITED TRANSACTIONS.—

(1) * * *

* * * * *

(4) DISALLOWANCE OF CERTAIN CHARITABLE DEDUCTIONS.—No gift or bequest shall be allowed as a deduction under section 170, 545(b)(2), [556(b)(2),] 642(c), 2055, 2106(a)(2), or 2522, if made—

(A) * * *

* * * * *

CHAPTER 43—QUALIFIED PENSION, ETC., PLANS

* * * * *

SEC. 4975. TAX ON PROHIBITED TRANSACTIONS.

(a) * * *

* * * * *

(d) EXEMPTIONS.—Except as provided in subsection (f)(6), the prohibitions provided in subsection (c) shall not apply to—

(1) * * *

* * * * *

(14) any transaction required or permitted under part 1 of subtitle E of title IV or section 4223 of the Employee Retirement Income Security Act of 1974, but this paragraph shall not apply with respect to the application of subsection (c)(1) (E) or (F); **[or]**

(15) a merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty Corporation to meet the requirements of section 4231 of such Act, but this paragraph shall not apply with respect to the application of subsection (c)(1) (E) or (F) **[.]; or**

(16) *a sale of stock held by a trust which constitutes an individual retirement account under section 408(a) to the individual for whose benefit such account is established if—*

(A) *such stock is in a bank (as defined in section 581),*

(B) *such stock is held by such trust as of the date of the enactment of this paragraph,*

(C) *such sale is pursuant to an election under section 1362(a) by such bank,*

(D) *such sale is for fair market value at the time of sale (as established by an independent appraiser) and the terms of the sale are otherwise at least as favorable to such trust as the terms that would apply on a sale to an unrelated party,*

(E) *such trust does not pay any commissions, costs, or other expenses in connection with the sale, and*

(F) *the stock is sold in a single transaction for cash not later than 120 days after the S corporation election is made.*

* * * * *

(f) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) * * *

* * * * *

(7) *S CORPORATION REPAYMENT OF LOANS FOR QUALIFYING EMPLOYER SECURITIES.—A plan shall not be treated as violating the requirements of section 401 or 409 or subsection (e)(7), or*

as engaging in a prohibited transaction for purposes of subsection (d)(3), merely by reason of any distribution (as described in section 1368(a)) with respect to S corporation stock that constitutes qualifying employer securities, which in accordance with the plan provisions is used to make payments on a loan described in subsection (d)(3) the proceeds of which were used to acquire such qualifying employer securities (whether or not allocated to participants). The preceding sentence shall not apply in the case of a distribution which is paid with respect to any employer security which is allocated to a participant unless the plan provides that employer securities with a fair market value of not less than the amount of such distribution are allocated to such participant for the year which (but for the preceding sentence) such distribution would have been allocated to such participant.

* * * * *

CHAPTER 45—PROVISIONS RELATING TO EXPATRIATED ENTITIES

Sec. 4985. Stock compensation of insiders in expatriated corporations.

SEC. 4985. STOCK COMPENSATION OF INSIDERS IN EXPATRIATED CORPORATIONS.

(a) IMPOSITION OF TAX.—In the case of an individual who is a disqualified individual with respect to any expatriated corporation, there is hereby imposed on such person a tax equal to 15 percent of the value (determined under subsection (b)) of the specified stock compensation held (directly or indirectly) by or for the benefit of such individual or a member of such individual's family (as defined in section 267) at any time during the 12-month period beginning on the date which is 6 months before the expatriation date.

(b) VALUE.—For purposes of subsection (a)—

(1) IN GENERAL.—The value of specified stock compensation shall be—

(A) in the case of a stock option (or other similar right) or a stock appreciation right, the fair value of such option or right, and

(B) in any other case, the fair market value of such compensation.

(2) DATE FOR DETERMINING VALUE.—The determination of value shall be made—

(A) in the case of specified stock compensation held on the expatriation date, on such date,

(B) in the case of such compensation which is canceled during the 6 months before the expatriation date, on the day before such cancellation, and

(C) in the case of such compensation which is granted after the expatriation date, on the date such compensation is granted.

(c) TAX TO APPLY ONLY IF SHAREHOLDER GAIN RECOGNIZED.—Subsection (a) shall apply to any disqualified individual with respect to an expatriated corporation only if gain (if any) on any stock

in such corporation is recognized in whole or part by any shareholder by reason of the acquisition referred to in section 7874(a)(2)(B)(i) with respect to such corporation.

(d) EXCEPTION WHERE GAIN RECOGNIZED ON COMPENSATION.—Subsection (a) shall not apply to—

(1) any stock option which is exercised on the expatriation date or during the 6-month period before such date and to the stock acquired in such exercise, if income is recognized under section 83 on or before the expatriation date with respect to the stock acquired pursuant to such exercise, and

(2) any other specified stock compensation which is exercised, sold, exchanged, distributed, cashed-out, or otherwise paid during such period in a transaction in which income, gain, or loss is recognized in full.

(e) DEFINITIONS.—For purposes of this section—

(1) DISQUALIFIED INDIVIDUAL.—The term “disqualified individual” means, with respect to a corporation, any individual who, at any time during the 12-month period beginning on the date which is 6 months before the expatriation date—

(A) is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 with respect to such corporation or any member of the expanded affiliated group which includes such corporation, or

(B) would be subject to such requirements if such corporation or member were an issuer of equity securities referred to in such section.

(2) EXPATRIATED CORPORATION; EXPATRIATION DATE.—

(A) EXPATRIATED CORPORATION.—The term “expatriated corporation” means any corporation which is an expatriated entity (as defined in section 7874(a)(2)). Such term includes any predecessor or successor of such a corporation.

(B) EXPATRIATION DATE.—The term “expatriation date” means, with respect to a corporation, the date on which the corporation first becomes an expatriated corporation.

(3) SPECIFIED STOCK COMPENSATION.—

(A) IN GENERAL.—The term “specified stock compensation” means payment (or right to payment) granted by the expatriated corporation (or by any member of the expanded affiliated group which includes such corporation) to any person in connection with the performance of services by a disqualified individual for such corporation or member if the value of such payment or right is based on (or determined by reference to) the value (or change in value) of stock in such corporation (or any such member).

(B) EXCEPTIONS.—Such term shall not include—

(i) any option to which part II of subchapter D of chapter 1 applies, or

(ii) any payment or right to payment from a plan referred to in section 280G(b)(6).

(4) EXPANDED AFFILIATED GROUP.—The term “expanded affiliated group” means an affiliated group (as defined in section 1504(a) without regard to section 1504(b)(3)); except that section 1504(a) shall be applied by substituting “more than 50 percent” for “at least 80 percent” each place it appears.

(f) *SPECIAL RULES.—For purposes of this section—*

(1) *CANCELLATION OF RESTRICTION.—The cancellation of a restriction which by its terms will never lapse shall be treated as a grant.*

(2) *PAYMENT OR REIMBURSEMENT OF TAX BY CORPORATION TREATED AS SPECIFIED STOCK COMPENSATION.—Any payment of the tax imposed by this section directly or indirectly by the expatriated corporation or by any member of the expanded affiliated group which includes such corporation—*

(A) *shall be treated as specified stock compensation, and*

(B) *shall not be allowed as a deduction under any provision of chapter 1.*

(3) *CERTAIN RESTRICTIONS IGNORED.—Whether there is specified stock compensation, and the value thereof, shall be determined without regard to any restriction other than a restriction which by its terms will never lapse.*

(4) *PROPERTY TRANSFERS.—Any transfer of property shall be treated as a payment and any right to a transfer of property shall be treated as a right to a payment.*

(5) *OTHER ADMINISTRATIVE PROVISIONS.—For purposes of subtitle F, any tax imposed by this section shall be treated as a tax imposed by subtitle A.*

(g) *REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.*

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Subtitle E—Alcohol, Tobacco, and Certain Other Excise Taxes

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CHAPTER 51—DISTILLED SPIRITS, WINES, AND BEER

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Subchapter A—Gallonage and Occupational Taxes

* * * * *

PART I—GALLONAGE TAXES

* * * * *

Subpart A—Distilled Spirits

Sec. 5001. Imposition, rate, and attachment of tax.

* * * * *

Sec. 5011. *Income tax credit for wholesaler's average cost of carrying excise tax.*

* * * * *

SEC. 5011. INCOME TAX CREDIT FOR WHOLESALER'S AVERAGE COST OF CARRYING EXCISE TAX.

(a) *IN GENERAL.*—For purposes of section 38, in the case of an eligible wholesaler, the amount of the distilled spirits wholesalers credit for any taxable year is the amount equal to the product of—

- (1) the number of cases of bottled distilled spirits—
 - (A) which were bottled in the United States, and
 - (B) which are purchased by such wholesaler during the taxable year directly from the bottler of such spirits, and
- (2) the average tax-financing cost per case for the most recent calendar year ending before the beginning of such taxable year.

(b) *ELIGIBLE WHOLESALER.*—For purposes of this section, the term “eligible wholesaler” means any person who holds a permit under the Federal Alcohol Administration Act as a wholesaler of distilled spirits.

(c) *AVERAGE TAX-FINANCING COST.*—

(1) *IN GENERAL.*—For purposes of this section, the average tax-financing cost per case for any calendar year is the amount of interest which would accrue at the deemed financing rate during a 60-day period on an amount equal to the deemed Federal excise per case.

(2) *DEEMED FINANCING RATE.*—For purposes of paragraph (1), the deemed financing rate for any calendar year is the average of the corporate overpayment rates under paragraph (1) of section 6621(a) (determined without regard to the last sentence of such paragraph) for calendar quarters of such year.

(3) *DEEMED FEDERAL EXCISE TAX BASED ON CASE OF 12 80-PROOF 750ML BOTTLES.*—For purposes of paragraph (1), the deemed Federal excise tax per case is \$22.83.

(4) *NUMBER OF CASES IN LOT.*—For purposes of this section, the number of cases in any lot of distilled spirits shall be determined by dividing the number of liters in such lot by 9.

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PART II—OCCUPATIONAL TAX

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Subpart D—Wholesale Dealers

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SEC. 5117. PROHIBITED PURCHASES BY DEALERS.

(a) * * *

* * * * *

(d) *SPECIAL RULE DURING SUSPENSION PERIOD.*—Except as provided by the Secretary, during the suspension period (as defined in section 5148) it shall be unlawful for any dealer to purchase distilled spirits for resale from any person other than a wholesale dealer in liquors who is required to keep records under section 5114.

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Subpart G—General Provisions

Sec. 5141. Registration.

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[Sec. 5148. Cross references.]

Sec. 5148. *Suspension of occupational tax.*Sec. 5149. *Cross references.*

* * * * *

SEC. 5148. SUSPENSION OF OCCUPATIONAL TAX.

(a) *IN GENERAL.*—Notwithstanding sections 5081, 5091, 5111, 5121, and 5131, the rate of tax imposed under such sections for the suspension period shall be zero. During such period, persons engaged in or carrying on a trade or business covered by such sections shall register under section 5141 and shall comply with the record-keeping requirements under this part.

(b) *SUSPENSION PERIOD.*—For purposes of subsection (a), the suspension period is the period beginning on July 1, 2004, and ending on June 30, 2007.

SEC. [5148.] 5149. CROSS REFERENCES.

(1) For penalties for willful nonpayment of special taxes, see section 5691.

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Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—Returns and Records

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PART III—INFORMATION RETURNS

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Subpart A—Information Concerning Persons Subject to Special Provisions

Sec. 6031. Return of partnership income.

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[Sec. 6035. Returns of officers, directors, and shareholders of foreign personal holding companies.]

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[SEC. 6035. RETURNS OF OFFICERS, DIRECTORS, AND SHAREHOLDERS OF FOREIGN PERSONAL HOLDING COMPANIES.

[(a) *GENERAL RULE.*—Each United States citizen or resident who is an officer, director, or 10-percent shareholder of a corporation which was a foreign personal holding company (as defined in

section 552) for any taxable year shall file a return with respect to such taxable year setting forth—

[(1) the shareholder information required by subsection (b),

[(2) the income information required by subsection (c), and

[(3) such other information with respect to such corporation as the Secretary shall by forms or regulations prescribe as necessary for carrying out the purposes of this title.

[(b) SHAREHOLDER INFORMATION.—The shareholder information required by this subsection with respect to any taxable year shall be—

[(1) the name and address of each person who at any time during such taxable year held any share in the corporation,

[(2) a description of each class of shares and the total number of shares of such class outstanding at the close of the taxable year,

[(3) the number of shares of each class held by each person, and

[(4) any changes in the holdings of shares during the taxable year.

For purposes of paragraphs (1), (3), and (4), the term “share” includes any security convertible into a share in the corporation and any option granted by the corporation with respect to any share in the corporation.

[(c) INCOME INFORMATION.—The income information required by this subsection for any taxable year shall be the gross income, deductions, credits, taxable income, and undistributed foreign personal holding company income of the corporation for the taxable year.

[(d) TIME AND MANNER FOR FURNISHING INFORMATION.—The information required under subsection (a) shall be furnished at such time and in such manner as the Secretary shall by forms and regulations prescribe.

[(e) DEFINITION AND SPECIAL RULES.—

[(1) 10-PERCENT SHAREHOLDER.—For purposes of this section, the term “10-percent shareholder” means any individual who owns directly or indirectly (within the meaning of section 554) 10 percent or more in value of the outstanding stock of a foreign corporation.

[(2) TIME FOR MAKING DETERMINATIONS.—

[(A) IN GENERAL.—Except as provided in subparagraph (B), the determination of whether any person is an officer, director, or 10-percent shareholder with respect to any foreign corporation shall be made as of the date on which the return is required to be filed.

[(B) SPECIAL RULE.—If after the application of subparagraph (A) no person is required to file a return under subsection (a) with respect to any foreign corporation for any taxable year, the determination of whether any person is an officer, director, or 10-percent shareholder with respect to such foreign corporation shall be made on the last day of such taxable year on which there was such a person who was a United States citizen or resident.

[(3) 2 OR MORE PERSONS REQUIRED TO FURNISH INFORMATION WITH RESPECT TO SAME FOREIGN CORPORATION.—If, but for this paragraph, 2 or more persons would be required to furnish information under subsection (a) with respect to the same foreign corporation for the same taxable year, the Secretary may by regulations provide that such information shall be required only from 1 person.]

* * * * *

SEC. 6039G. INFORMATION ON INDIVIDUALS LOSING UNITED STATES CITIZENSHIP.

[(a) IN GENERAL.—Notwithstanding any other provision of law, any individual who loses United States citizenship (within the meaning of section 877(a) shall provide a statement which includes the information described in subsection (b). Such statement shall be—

[(1) provided not later than the earliest date of any act referred to in subsection (c), and

[(2) provided to the person or court referred to in subsection (c) with respect to such act.

[(b) INFORMATION TO BE PROVIDED.—Information required under subsection (a) shall include—

[(1) the taxpayer's TIN,

[(2) the mailing address of such individual's principal foreign residence,

[(3) the foreign country, in which such individual is residing,

[(4) the foreign country of which such individual is a citizen.

[(5) in the case of an individual having a net worth of at least the dollar amount applicable under section 877(a)(2)(B), information detailing the assets and liabilities of such individual, and

[(6) such other information as the Secretary may prescribe.

[(c) ACTS DESCRIBED.—For purposes of this section, the acts referred to in this subsection are—

[(1) the individual's renunciation of his United States nationality before a diplomatic or consular officer of the United States pursuant to paragraph (5) of section 349(a) of the Immigration and Nationality Act (8 U.S.C. 1481(a)(5)),

[(2) the individual's furnishing to the United States Department of State a signed statement of voluntary relinquishment of United States nationality confirming the performance of an act of expatriation specified in paragraph (1), (2), (3), or

[(4) of section 349(a) of the immigration and Nationality Act (8 U.S.C. 1481(a)(1)-(4)),

[(3) the issuance by the United States Department of State of a certificate of loss of nationality to the individual, or

[(4) the cancellation by a court of the United States of a naturalized citizen's certificate of naturalization.

[(d) PENALTY.—Any individual failing to provide a statement required under subsection (a) shall be subject to a penalty for each year (of the 10-year period beginning on the date of loss of United

States citizenship) during any portion of which such failure continues in an amount equal to the greater of—

[(1) 5 percent of the tax required to be paid under section 877 for the taxable year ending during such year, or

[(2) \$1,000, unless it is shown that such failure is due to reasonable cause and not to willful neglect.]

(a) *IN GENERAL.*—Notwithstanding any other provision of law, any individual to whom section 877(b) applies for any taxable year shall provide a statement for such taxable year which includes the information described in subsection (b).

(b) *INFORMATION TO BE PROVIDED.*—Information required under subsection (a) shall include—

(1) the taxpayer's TIN,

(2) the mailing address of such individual's principal foreign residence,

(3) the foreign country in which such individual is residing,

(4) the foreign country of which such individual is a citizen,

(5) information detailing the income, assets, and liabilities of such individual,

(6) the number of days during any portion of which that the individual was physically present in the United States during the taxable year, and

(7) such other information as the Secretary may prescribe.

(c) *PENALTY.*—If—

(1) an individual is required to file a statement under subsection (a) for any taxable year, and

(2) fails to file such a statement with the Secretary on or before the date such statement is required to be filed or fails to include all the information required to be shown on the statement or includes incorrect information,

such individual shall pay a penalty of \$10,000 unless it is shown that such failure is due to reasonable cause and not to willful neglect.

[(e)] (d) *INFORMATION TO BE PROVIDED TO SECRETARY.*—Notwithstanding any other provision of law—

(1) * * *

* * * * *

[(f) *REPORTING BY LONG-TERM LAWFUL PERMANENT RESIDENTS WHO CEASE TO BE TAXED AS RESIDENTS.*—In lieu of applying the last sentence of subsection (a), any individual who is required to provide a statement under this section by reason of section 877(e)(1) shall provide such statement with the return of tax imposed by chapter 1 for the taxable year during which the event described in such section occurs.

[(g) *EXEMPTION.*—The Secretary may by regulations exempt any class of individuals from the requirements of this section if he determines that applying this section to such individuals is not necessary to carry out the purposes of this section.]

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Subpart B—Information Concerning Transactions With Other Persons

Sec. 6041. Information at source.

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Sec. 6043A. Returns relating to taxable mergers and acquisitions.

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SEC. 6043A. RETURNS RELATING TO TAXABLE MERGERS AND ACQUISITIONS.

(a) *IN GENERAL.*—According to the forms or regulations prescribed by the Secretary, the acquiring corporation in any taxable acquisition shall make a return setting forth—

- (1) a description of the acquisition,
- (2) the name and address of each shareholder of the acquired corporation who is required to recognize gain (if any) as a result of the acquisition,
- (3) the amount of money and the fair market value of other property transferred to each such shareholder as part of such acquisition, and
- (4) such other information as the Secretary may prescribe.

To the extent provided by the Secretary, the requirements of this section applicable to the acquiring corporation shall be applicable to the acquired corporation and not to the acquiring corporation.

(b) *NOMINEES.*—According to the forms or regulations prescribed by the Secretary—

(1) *REPORTING.*—Any person who holds stock as a nominee for another person shall furnish in the manner prescribed by the Secretary to such other person the information provided by the corporation under subsection (d).

(2) *REPORTING TO NOMINEES.*—In the case of stock held by any person as a nominee, references in this section (other than in subsection (c)) to a shareholder shall be treated as a reference to the nominee.

(c) *TAXABLE ACQUISITION.*—For purposes of this section, the term “taxable acquisition” means any acquisition by a corporation of stock in or property of another corporation if any shareholder of the acquired corporation is required to recognize gain (if any) as a result of such acquisition.

(d) *STATEMENTS TO BE FURNISHED TO SHAREHOLDERS.*—According to the forms or regulations prescribed by the Secretary, every person required to make a return under subsection (a) shall furnish to each shareholder whose name is required to be set forth in such return a written statement showing—

- (1) the name, address, and phone number of the information contact of the person required to make such return,
- (2) the information required to be shown on such return with respect to such shareholder, and
- (3) such other information as the Secretary may prescribe.

The written statement required under the preceding sentence shall be furnished to the shareholder on or before January 31 of the year following the calendar year during which the taxable acquisition occurred.

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Subpart C—Information Regarding Wages Paid Employees

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SEC. 6051. RECEIPTS FOR EMPLOYEES,

(a) REQUIREMENT.—Every person required to deduct and withhold from an employee a tax under section 3101 or 3402, or who would have been required to deduct and withhold a tax under section 3402 (determined without regard to subsection (n)) if the employee had claimed no more than one withholding exemption, or every employer engaged in a trade or business who pays remuneration for services performed by an employee, including the cash value of such remuneration paid in any medium other than cash, shall furnish to each such employee in respect of the remuneration paid by such person to such employee during the calendar year, on or before January 31 of the succeeding year, or, if his employment is terminated before the close of such calendar year, within 30 days after the date of receipt of a written request from the employee if such 30-day period ends before January 31, a written statement showing the following:

(1) * * *

* * * * *

(10) in the case of an employee who is a member of the Armed Forces of the United States, such employee's earned income as determined for purposes of section 32 (relating to earned income credit), **[and]**

(11) the amount contributed to any Archer MSA (as defined in section 220(d) of such employee or such employee's spouse~~...~~), **and**

(12) *the total amount of deferrals under a nonqualified deferred compensation plan (within the meaning of section 409A(d)).*

In the case of compensation paid for service as a member of a uniformed service, the statement shall show, in lieu of the amount required to be shown by paragraph (5), the total amount of wages as defined in section 3121(a), computed in accordance with such section and section 3121(i)(2). In the case of compensation paid for service as a volunteer or volunteer leader within the meaning of the Peace Corps Act, the statement shall show, in lieu of the amount required to be shown by paragraph (5), the total amount of wages as defined in section 3121(a), computed in accordance with such section and section 3121(i)(3). In the case of tips received by an employee in the course of his employment, the amounts required to be shown by paragraphs (3) and (5) shall include only such tips as are included in statements furnished to the employer pursuant to section 6053(a). The amounts required to be shown by paragraph (5) shall not include wages which are exempted pursuant to sections 3101(c) and 3111(c) from the taxes imposed by sections 3101 and 3111. *In the case of the amounts required to be shown by paragraph (12), the Secretary (by regulation) may establish a minimum amount of deferrals below which paragraph (12) does not apply and may provide that paragraph (12) does not apply*

with respect to amounts of deferrals which are not reasonably ascertainable.

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Subchapter B—Miscellaneous Provisions

Sec. 6101. Period covered by returns or other documents.

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[Sec. 6111. Registration of tax shelters.

[Sec. 6112. Organizers and sellers of potentially abusive tax shelters must keep lists of investors.**]**

Sec. 6111. Disclosure of reportable transactions.

Sec. 6112. Material advisors of reportable transactions must keep lists of advisees, etc.

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SEC. 6103. CONFIDENTIALITY AND DISCLOSURE OF RETURNS AND RETURN INFORMATION.

(a) * * *

* * * * *

(e) DISCLOSURE TO PERSONS HAVING MATERIAL INTEREST.—

(1) IN GENERAL.—The return of a person shall, upon written request, be open to inspection by or disclosure to—

(A) * * *

* * * * *

(D) in the case of the return of a corporation or a subsidiary thereof—

(i) * * *

* * * * *

[(iv) if the corporation was a foreign personal holding company, as defined by section 552, any person who was a shareholder during any part of a period covered by such return if with respect to that period, or any part thereof, such shareholder was required under section 551 to include in his gross income undistributed foreign personal holding company income of such company,**]**

[(v) *(iv)* if the corporation was an S corporation, any person who was a shareholder during any part of the period covered by such return during which an election under section 1362(a) was in effect, or

[(vi) *(v)* if the corporation has been dissolved, any person authorized by applicable State law to act for the corporation or any person who the Secretary finds to have a material interest which will be affected by information contained therein;

* * * * *

[SEC. 6111. REGISTRATION OF TAX SHELTERS.

[(a) REGISTRATION.—

[(1) IN GENERAL.—Any tax shelter organizer shall register the tax shelter with the Secretary (in such form and in such manner as the Secretary may prescribe) not later than the day

on which the first offering for sale of interests in such tax shelter occurs.

[(2) INFORMATION INCLUDED IN REGISTRATION.—Any registration under paragraph (1) shall include—

[(A) information identifying and describing the tax shelter,

[(B) information describing the tax benefits of the tax shelter represented (or to be represented) to investors, and

[(C) such other information as the Secretary may prescribe.

[(b) FURNISHING OF TAX SHELTER IDENTIFICATION NUMBER; INCLUSION ON RETURN.—

[(1) SELLERS, ETC.—Any person who sells (or otherwise transfers) an interest in a tax shelter shall (at such times and in such manner as the Secretary shall prescribe) furnish to each investor who purchases (or otherwise acquires) an interest in such tax shelter from such person the identification number assigned by the Secretary to such tax shelter.

[(2) INCLUSION OF NUMBER ON RETURN.—Any person claiming any deduction, credit, or other tax benefit by reason of a tax shelter shall include (in such manner as the Secretary may prescribe) on the return of tax on which such deduction, credit, or other benefit is claimed the identification number assigned by the Secretary to such tax shelter.

[(c) TAX SHELTER.—For purposes of this section—

[(1) IN GENERAL.—The term “tax shelter” means any investment—

[(A) with respect to which any person could reasonably infer from the representations made, or to be made, in connection with the offering for sale of interests in the investment that the tax shelter ratio for any investor as of the close of any of the first 5 years ending after the date on which such investment is offered for sale may be greater than 2 to 1, and

[(B) which is—

[(i) required to be registered under a Federal or State law regulating securities,

[(ii) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or State agency regulating the offering or sale of securities, or

[(iii) a substantial investment.

[(2) TAX SHELTER RATIO DEFINED.—For purposes of this subsection, the term “tax shelter ratio” means, with respect to any year, the ratio which—

[(A) the aggregate amount of the deductions and 350 percent of the credits which are represented to be potentially allowable to any investor under subtitle A for all periods up to (and including) the close of such year, bears to

[(B) the investment base as of the close of such year.

[(3) INVESTMENT BASE.—

[(A) IN GENERAL.—Except as provided in this paragraph, the term “investment base” means, with respect to any year, the amount of money and the adjusted basis of

other property (reduced by any liability to which such other property is subject) contributed by the investor as of the close of such year.

[(B) CERTAIN BORROWED AMOUNTS EXCLUDED.—For purposes of subparagraph (A), there shall not be taken into account any amount borrowed from any person—

[(i) who participated in the organization, sale, or management of the investment, or

[(ii) who is a related person (as defined in section 465(b)(3)(C)) to any person described in clause (i), unless such amount is unconditionally required to be repaid by the investor before the close of the year for which the determination is being made.

[(C) CERTAIN OTHER AMOUNTS INCLUDED OR EXCLUDED.—

[(i) AMOUNTS HELD IN CASH EQUIVALENTS, ETC.—No amount shall be taken into account under subparagraph (A) which is to be held in cash equivalent or marketable securities.

[(ii) AMOUNTS INCLUDED OR EXCLUDED BY SECRETARY.—The Secretary may by regulation—

[(I) exclude from the investment base any amount described in subparagraph (A), or

[(II) include in the investment base any amount not described in subparagraph (A), if the Secretary determines that such exclusion or inclusion is necessary to carry out the purposes of this section.

[(4) SUBSTANTIAL INVESTMENT.—An investment is a substantial investment if—

[(A) the aggregate amount which may be offered for sale exceeds \$250,000, and

[(B) there are expected to be 5 or more investors.

[(d) CERTAIN CONFIDENTIAL ARRANGEMENTS TREATED AS TAX SHELTERS.—

[(1) IN GENERAL.—For purposes of this section, the term “tax shelter” includes any entity, plan, arrangement, or transaction—

[(A) a significant purpose of the structure of which is the avoidance or evasion of Federal income tax for a direct or indirect participant which is a corporation,

[(B) which is offered to any potential participant under conditions of confidentiality, and

[(C) for which the tax shelter promoters may receive fees in excess of \$100,000 in the aggregate.

[(2) CONDITIONS OF CONFIDENTIALITY.—For purposes of paragraph (1)(B), an offer is under conditions of confidentiality if—

[(A) the potential participant to whom the offer is made (or any other person acting on behalf of such participant) has an understanding or agreement with or for the benefit of any promoter of the tax shelter that such participant (or such other person) will limit disclosure of the tax shelter or any significant tax features of the tax shelter, or

[(B) any promoter of the tax shelter—

[(i) claims, knows, or has reason to know,

[(ii) knows or has reason to know that any other person (other than the potential participant) claims, or

[(iii) causes another person to claim, that the tax shelter (or any aspect thereof) is proprietary to any person other than the potential participant or is otherwise protected from disclosure to or use by others.

For purposes of this subsection, the term “promoter” means any person or any related person (within the meaning of section 267 or 707) who participates in the organization, management, or sale of the tax shelter.

[(3) PERSONS OTHER THAN PROMOTER REQUIRED TO REGISTER IN CERTAIN CASES.—

[(A) IN GENERAL.—If—

[(i) the requirements of subsection (a) are not met with respect to any tax shelter (as defined in paragraph (1)) by any tax shelter promoter, and

[(ii) no tax shelter promoter is a United States person, then each United States person who discussed participation in such shelter shall register such shelter under subsection (a).

[(B) EXCEPTION.—Subparagraph (A) shall not apply to a United States person who discussed participation in a tax shelter if—

[(i) such person notified the promoter in writing (not later than the close of the 90th day after the day on which such discussions began) that such person would not participate in such shelter, and

[(ii) such person does not participate in such shelter.

[(4) OFFER TO PARTICIPATE TREATED AS OFFER FOR SALE.—For purposes of subsections (a) and (b), an offer to participate in a tax shelter (as defined in paragraph (1)) shall be treated as an offer for sale.

[(e) OTHER DEFINITIONS.—For purposes of this section—

[(1) TAX SHELTER ORGANIZER.—The term “tax shelter organizer” means—

[(A) the person principally responsible for organizing the tax shelter,

[(B) if the requirements of subsection (a) are not met by a person described in subparagraph (A) at the time prescribed therefor, any other person who participated in the organization of the tax shelter, and

[(C) if the requirements of subsection (a) are not met by a person described in subparagraph (A) or (B) at the time prescribed therefor, any person participating in the sale or management of the investment at a time when the tax shelter was not registered under subsection (a).

[(2) YEAR.—The term “year” means—

[(A) the taxable year of the tax shelter, or

[(B) if the tax shelter has no taxable year, the calendar year.

[(f) REGULATIONS.—The Secretary may prescribe regulations which provide—

[(1) rules for the aggregation of similar investments offered by the same person or persons for purposes of applying subsection (c)(4),

[(2) that only 1 person shall be required to meet the requirements of subsection (a) in cases in which 2 or more persons would otherwise be required to meet such requirements,

[(3) exemptions from the requirements of this section, and

[(4) such rules as may be necessary or appropriate to carry out the purposes of this section in the case of foreign tax shelters.

[SEC. 6112. ORGANIZERS AND SELLERS OF POTENTIALLY ABUSIVE TAX SHELTERS MUST KEEP LISTS OF INVESTORS.

[(a) IN GENERAL.—Any person who—

[(1) organizes any potentially abusive tax shelter, or

[(2) sells any interest in such a shelter, shall maintain (in such manner as the Secretary may by regulations prescribe) a list identifying each person who was sold an interest in such shelter and containing such other information as the Secretary may by regulations require.

[(b) POTENTIALLY ABUSIVE TAX SHELTER.—For purposes of this section, the term “potentially abusive tax shelter” means—

[(1) any tax shelter (as defined in section 6111) with respect to which registration is required under section 6111, and

[(2) any entity, investment plan or arrangement, or other plan or arrangement which is of a type which the Secretary determines by regulations as having a potential for tax avoidance or evasion.]

SEC. 6111. DISCLOSURE OF REPORTABLE TRANSACTIONS.

(a) *IN GENERAL.*—Each material advisor with respect to any reportable transaction shall make a return (in such form as the Secretary may prescribe) setting forth—

(1) *information identifying and describing the transaction,*

(2) *information describing any potential tax benefits expected to result from the transaction, and*

(3) *such other information as the Secretary may prescribe.*

Such return shall be filed not later than the date specified by the Secretary.

(b) *DEFINITIONS.*—For purposes of this section—

(1) *MATERIAL ADVISOR.*—

(A) *IN GENERAL.*—The term “material advisor” means any person—

(i) *who provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, or carrying out any reportable transaction, and*

(ii) *who directly or indirectly derives gross income in excess of the threshold amount (or such other amount as may be prescribed by the Secretary) for such advice or assistance.*

(B) *THRESHOLD AMOUNT.*—For purposes of subparagraph (A), the threshold amount is—

(i) \$50,000 in the case of a reportable transaction substantially all of the tax benefits from which are provided to natural persons, and

(ii) \$250,000 in any other case.

(2) **REPORTABLE TRANSACTION.**—The term “reportable transaction” has the meaning given to such term by section 6707A(c).

(c) **REGULATIONS.**—The Secretary may prescribe regulations which provide—

(1) that only 1 person shall be required to meet the requirements of subsection (a) in cases in which 2 or more persons would otherwise be required to meet such requirements,

(2) exemptions from the requirements of this section, and

(3) such rules as may be necessary or appropriate to carry out the purposes of this section.

SEC. 6112. MATERIAL ADVISORS OF REPORTABLE TRANSACTIONS MUST KEEP LISTS OF ADVISEES, ETC.

(a) **IN GENERAL.**—Each material advisor (as defined in section 6111) with respect to any reportable transaction (as defined in section 6707A(c)) shall (whether or not required to file a return under section 6111 with respect to such transaction) maintain (in such manner as the Secretary may by regulations prescribe) a list—

(1) identifying each person with respect to whom such advisor acted as a material advisor with respect to such transaction, and

(2) containing such other information as the Secretary may by regulations require.

[(c)] (b) **SPECIAL RULES.**—

(1) **AVAILABILITY FOR INSPECTION; RETENTION OF INFORMATION ON LIST.**—Any person who is required to maintain a list under subsection (a)—

(A) shall make such list available to the Secretary for inspection upon *written* request by the Secretary, and

(B) except as otherwise provided under regulations prescribed by the Secretary, shall retain any information which is required to be included on such list for 7 years.

For purposes of this section, the identity of any person on such list shall not be privileged.

(2) **LISTS WHICH WOULD BE REQUIRED TO BE MAINTAINED BY 2 OR MORE PERSONS.**—The Secretary [shall] *may* prescribe regulations which provide that, in cases in which 2 or more persons are required under subsection (a) to maintain the same list (or portion thereof), only 1 person shall be required to maintain such list (or portion).

* * * * *

CHAPTER 62—TIME AND PLACE FOR PAYING TAX

* * * * *

Subchapter A—Place and Due Date for Payment of Tax

* * * * *

SEC. 6159. AGREEMENTS FOR PAYMENT OF TAX LIABILITY IN INSTALLMENTS.

(a) **AUTHORIZATION OF AGREEMENTS.**—The Secretary is authorized to enter into written agreements with any taxpayer under which such taxpayer is allowed to **[satisfy liability for payment of]** *make payment on* any tax in installment payments if the Secretary determines that such agreement will facilitate *full or partial* collection of such liability.

* * * * *

(c) **SECRETARY REQUIRED TO ENTER INTO INSTALLMENT AGREEMENTS IN CERTAIN CASES.**—In the case of a liability for tax of an individual under subtitle A, the Secretary shall enter into an agreement to accept the *full* payment of such tax in installments if, as of the date the individual offers to enter into the agreement—

(1) * * *

* * * * *

(d) **SECRETARY REQUIRED TO REVIEW INSTALLMENT AGREEMENTS FOR PARTIAL COLLECTION EVERY TWO YEARS.**—*In the case of an agreement entered into by the Secretary under subsection (a) for partial collection of a tax liability, the Secretary shall review the agreement at least once every 2 years.*

[(d)] (e) ADMINISTRATIVE REVIEW.—The Secretary shall establish procedures for an independent administrative review of terminations of installment agreements under this section for taxpayers who request such a review.

[(e)] (f) CROSS REFERENCE.—

For rights to administrative review and appeal, see section 7122(d).

CHAPTER 66—LIMITATIONS

* * * * *

Subchapter A—Limitations on Assessment and Collection

* * * * *

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) * * *

* * * * *

(c) **EXCEPTIONS.**—

(1) * * *

* * * * *

(10) **LISTED TRANSACTIONS.**—*If a taxpayer fails to include on any return or statement for any taxable year any information with respect to a listed transaction (as defined in section 6707A(c)(2)) which is required under section 6011 to be in-*

cluded with such return or statement, the time for assessment of any tax imposed by this title with respect to such transaction shall not expire before the date which is 1 year after the earlier of—

(A) the date on which the Secretary is furnished the information so required, or

(B) the date that a material advisor (as defined in section 6111) meets the requirements of section 6112 with respect to a request by the Secretary under section 6112(b) relating to such transaction with respect to such taxpayer.

* * * * *

(e) **SUBSTANTIAL OMISSION OF ITEMS.**—Except as otherwise provided in subsection (c)—

(1) **INCOME TAXES.**—In the case of any tax imposed by subtitle A—

(A) * * *

[(B) CONSTRUCTIVE DIVIDENDS.—If the taxpayer omits from gross income an amount properly includible therein under section 551(b) (relating to the inclusion in the gross income of United States shareholders of their distributive shares of the undistributed foreign personal holding company income), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed.]

(B) CONSTRUCTIVE DIVIDENDS.—If the taxpayer omits from gross income an amount properly includible therein under section 951(a), the tax may be assessed, or a proceeding in court for the collection of such tax may be done without assessing, at any time within 6 years after the return was filed.

* * * * *

CHAPTER 67—INTEREST

* * * * *

Subchapter A—Interest on Underpayments

Sec. 6601. Interest on underpayment, nonpayment, or extensions of time for payment, of tax.

* * * * *

Sec. 6603. *Deposits made to suspend running of interest on potential underpayments, etc.*

* * * * *

SEC. 6603. DEPOSITS MADE TO SUSPEND RUNNING OF INTEREST ON POTENTIAL UNDERPAYMENTS, ETC.

(a) AUTHORITY TO MAKE DEPOSITS OTHER THAN AS PAYMENT OF TAX.—A taxpayer may make a cash deposit with the Secretary which may be used by the Secretary to pay any tax imposed under subtitle A or B or chapter 41, 42, 43, or 44 which has not been as-

essed at the time of the deposit. Such a deposit shall be made in such manner as the Secretary shall prescribe.

(b) *NO INTEREST IMPOSED.*—To the extent that such deposit is used by the Secretary to pay tax, for purposes of section 6601 (relating to interest on underpayments), the tax shall be treated as paid when the deposit is made.

(c) *RETURN OF DEPOSIT.*—Except in a case where the Secretary determines that collection of tax is in jeopardy, the Secretary shall return to the taxpayer any amount of the deposit (to the extent not used for a payment of tax) which the taxpayer requests in writing.

(d) *PAYMENT OF INTEREST.*—

(1) *IN GENERAL.*—For purposes of section 6611 (relating to interest on overpayments), a deposit which is returned to a taxpayer shall be treated as a payment of tax for any period to the extent (and only to the extent) attributable to a disputable tax for such period. Under regulations prescribed by the Secretary, rules similar to the rules of section 6611(b)(2) shall apply.

(2) *DISPUTABLE TAX.*—

(A) *IN GENERAL.*—For purposes of this section, the term “disputable tax” means the amount of tax specified at the time of the deposit as the taxpayer’s reasonable estimate of the maximum amount of any tax attributable to disputable items.

(B) *SAFE HARBOR BASED ON 30-DAY LETTER.*—In the case of a taxpayer who has been issued a 30-day letter, the maximum amount of tax under subparagraph (A) shall not be less than the amount of the proposed deficiency specified in such letter.

(3) *OTHER DEFINITIONS.*—For purposes of paragraph (2)—

(A) *DISPUTABLE ITEM.*—The term “disputable item” means any item of income, gain, loss, deduction, or credit if the taxpayer—

(i) has a reasonable basis for its treatment of such item, and

(ii) reasonably believes that the Secretary also has a reasonable basis for disallowing the taxpayer’s treatment of such item.

(B) *30-DAY LETTER.*—The term “30-day letter” means the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals.

(4) *RATE OF INTEREST.*—The rate of interest allowable under this subsection shall be the Federal short-term rate determined under section 6621(b), compounded daily.

(e) *USE OF DEPOSITS.*—

(1) *PAYMENT OF TAX.*—Except as otherwise provided by the taxpayer, deposits shall be treated as used for the payment of tax in the order deposited.

(2) *RETURNS OF DEPOSITS.*—Deposits shall be treated as returned to the taxpayer on a last-in, first-out basis.

* * * * *

CHAPTER 68—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

* * * * *

Subchapter A—Additions to the Tax and Additional Amounts

* * * * *

PART II—ACCURACY-RELATED AND FRAUD PENALTIES

[Sec. 6662. Imposition of accuracy-related penalty.]

Sec. 6662. Imposition of accuracy-related penalty on underpayments.

Sec. 6662A. Imposition of accuracy-related penalty on understatements with respect to reportable transactions.

* * * * *

[SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY.]

SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY ON UNDERPAYMENTS.

(a) * * *

* * * * *

(d) SUBSTANTIAL UNDERSTATEMENT OF INCOME TAX.—

(1) SUBSTANTIAL UNDERSTATEMENT.—

(A) * * *

[(B) SPECIAL RULE FOR CORPORATIONS.—In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), paragraph (1) shall be applied by substituting “\$10,000” for “\$5,000”.]

(B) SPECIAL RULE FOR CORPORATIONS.—*In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of—*

(i) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, \$10,000), or

(ii) \$10,000,000.

(2) UNDERSTATEMENT.—

(A) IN GENERAL.—For purposes of paragraph (1), the term “understatement” means the excess of—

(i) * * *

* * * * *

The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies.

* * * * *

[(C) SPECIAL RULES IN CASES INVOLVING TAX SHELTERS.—

[(i) IN GENERAL.—In the case of any item of a taxpayer other than a corporation which is attributable to a tax shelter—

[(I) subparagraph (B)(ii) shall not apply, and

[(II) subparagraph (B)(i) shall not apply unless (in addition to meeting the requirements of such subparagraph) the taxpayer reasonably believed that the tax treatment of such item by the taxpayer was more likely than not the proper treatment.

[(ii) SUBPARAGRAPH (B) NOT TO APPLY TO CORPORATIONS.—Subparagraph (B) shall not apply to any item of a corporation which is attributable to a tax shelter.

[(iii) TAX SHELTER.—For purposes of this subparagraph, the term “tax shelter” means—

[(I) a partnership or other entity,

[(II) any investment plan or arrangement, or

[(III) any other plan or arrangement,

if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.]

(C) REDUCTION NOT TO APPLY TO TAX SHELTERS.—

(i) IN GENERAL.—Subparagraph (B) shall not apply to any item attributable to a tax shelter.

(ii) TAX SHELTER.—For purposes of clause (i), the term “tax shelter” means—

(I) a partnership or other entity,

(II) any investment plan or arrangement, or

(III) any other plan or arrangement,

if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

* * * * *

SEC. 6662A. IMPOSITION OF ACCURACY-RELATED PENALTY ON UNDERSTATEMENTS WITH RESPECT TO REPORTABLE TRANSACTIONS.

(a) IMPOSITION OF PENALTY.—If a taxpayer has a reportable transaction understatement for any taxable year, there shall be added to the tax an amount equal to 20 percent of the amount of such understatement.

(b) REPORTABLE TRANSACTION UNDERSTATEMENT.—For purposes of this section—

(1) IN GENERAL.—The term “reportable transaction understatement” means the sum of—

(A) the product of—

(i) the amount of the increase (if any) in taxable income which results from a difference between the proper tax treatment of an item to which this section applies and the taxpayer’s treatment of such item (as shown on the taxpayer’s return of tax), and

(ii) the highest rate of tax imposed by section 1 (section 11 in the case of a taxpayer which is a corporation), and

(B) the amount of the decrease (if any) in the aggregate amount of credits determined under subtitle A which results from a difference between the taxpayer's treatment of an item to which this section applies (as shown on the taxpayer's return of tax) and the proper tax treatment of such item.

For purposes of subparagraph (A), any reduction of the excess of deductions allowed for the taxable year over gross income for such year, and any reduction in the amount of capital losses which would (without regard to section 1211) be allowed for such year, shall be treated as an increase in taxable income.

(2) *ITEMS TO WHICH SECTION APPLIES.*—This section shall apply to any item which is attributable to—

(A) any listed transaction, and

(B) any reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of Federal income tax.

(c) *HIGHER PENALTY FOR NONDISCLOSED TRANSACTIONS.*—Subsection (a) shall be applied by substituting “30 percent” for “20 percent” with respect to the portion of any reportable transaction understatement with respect to which the requirement of section 6664(d)(2)(A) is not met.

(d) *DEFINITIONS OF REPORTABLE AND LISTED TRANSACTIONS.*—For purposes of this section, the terms “reportable transaction” and “listed transaction” have the respective meanings given to such terms by section 6707A(c).

(e) *SPECIAL RULES.*—

(1) *COORDINATION WITH PENALTIES, ETC., ON OTHER UNDERSTATEMENTS.*—In the case of an understatement (as defined in section 6662(d)(2))—

(A) the amount of such understatement (determined without regard to this paragraph) shall be increased by the aggregate amount of reportable transaction understatements for purposes of determining whether such understatement is a substantial understatement under section 6662(d)(1), and

(B) the addition to tax under section 6662(a) shall apply only to the excess of the amount of the substantial understatement (if any) after the application of subparagraph (A) over the aggregate amount of reportable transaction understatements.

(2) *COORDINATION WITH OTHER PENALTIES.*—

(A) *APPLICATION OF FRAUD PENALTY.*—References to an underpayment in section 6663 shall be treated as including references to a reportable transaction understatement.

(B) *NO DOUBLE PENALTY.*—This section shall not apply to any portion of an understatement on which a penalty is imposed under section 6663.

(3) *SPECIAL RULE FOR AMENDED RETURNS.*—Except as provided in regulations, in no event shall any tax treatment included with an amendment or supplement to a return of tax be taken into account in determining the amount of any reportable transaction understatement if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted

by the Secretary regarding the examination of the return or such other date as is specified by the Secretary.

* * * * *

SEC. 6664. DEFINITIONS AND SPECIAL RULES.

(a) * * *

* * * * *

(c) **REASONABLE CAUSE EXCEPTION FOR UNDERPAYMENTS.**—

(1) **IN GENERAL.**—No penalty shall be imposed under [this part] section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

* * * * *

(d) **REASONABLE CAUSE EXCEPTION FOR REPORTABLE TRANSACTION UNDERSTATEMENTS.**—

(1) **IN GENERAL.**—No penalty shall be imposed under section 6662A with respect to any portion of a reportable transaction understatement if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

(2) **SPECIAL RULES.**—Paragraph (1) shall not apply to any reportable transaction understatement unless—

(A) the relevant facts affecting the tax treatment of the item are adequately disclosed in accordance with the regulations prescribed under section 6011,

(B) there is or was substantial authority for such treatment, and

(C) the taxpayer reasonably believed that such treatment was more likely than not the proper treatment.

A taxpayer failing to adequately disclose in accordance with section 6011 shall be treated as meeting the requirements of subparagraph (A) if the penalty for such failure was rescinded under section 6707A(d).

(3) **RULES RELATING TO REASONABLE BELIEF.**—For purposes of paragraph (2)(C)—

(A) **IN GENERAL.**—A taxpayer shall be treated as having a reasonable belief with respect to the tax treatment of an item only if such belief—

(i) is based on the facts and law that exist at the time the return of tax which includes such tax treatment is filed, and

(ii) relates solely to the taxpayer's chances of success on the merits of such treatment and does not take into account the possibility that a return will not be audited, such treatment will not be raised on audit, or such treatment will be resolved through settlement if it is raised.

(B) **CERTAIN OPINIONS MAY NOT BE RELIED UPON.**—

(i) **IN GENERAL.**—An opinion of a tax advisor may not be relied upon to establish the reasonable belief of a taxpayer if—

(I) the tax advisor is described in clause (ii), or

- (II) the opinion is described in clause (iii).
- (ii) **DISQUALIFIED TAX ADVISORS.**—A tax advisor is described in this clause if the tax advisor—
- (I) is a material advisor (within the meaning of section 6111(b)(1)) and participates in the organization, management, promotion, or sale of the transaction or is related (within the meaning of section 267(b) or 707(b)(1)) to any person who so participates,
- (II) is compensated directly or indirectly by a material advisor with respect to the transaction,
- (III) has a fee arrangement with respect to the transaction which is contingent on all or part of the intended tax benefits from the transaction being sustained, or
- (IV) as determined under regulations prescribed by the Secretary, has a disqualifying financial interest with respect to the transaction.
- (iii) **DISQUALIFIED OPINIONS.**—For purposes of clause (i), an opinion is disqualified if the opinion—
- (I) is based on unreasonable factual or legal assumptions (including assumptions as to future events),
- (II) unreasonably relies on representations, statements, findings, or agreements of the taxpayer or any other person,
- (III) does not identify and consider all relevant facts, or
- (IV) fails to meet any other requirement as the Secretary may prescribe.

Subchapter B—Assessable Penalties

* * * * *

PART I—GENERAL PROVISIONS

Sec. 6671. Rules for application of assessable penalties.

* * * * *

Sec. 6707. Failure to furnish information regarding [tax shelters] reportable transactions.

Sec. 6707A. Penalty for failure to include reportable transaction information with return.

[Sec. 6708. Failure to maintain lists of investors in potentially abusive tax shelters.]

Sec. 6708. Failure to maintain lists of advisees with respect to reportable transactions.

* * * * *

SEC. 6679. FAILURE TO FILE RETURNS, ETC., WITH RESPECT TO FOREIGN CORPORATIONS OR FOREIGN PARTNERSHIPS.

(a) CIVIL PENALTY.—

(1) IN GENERAL.—In addition to any criminal penalty provided by law, any person required to file a return under section [6035, 6046, or 6046A] 6046 or 6046A who fails to file such return at the time provided in such section, or who files a re-

turn which does not show the information required pursuant to such section, shall pay a penalty of \$10,000, unless it is shown that such failure is due to reasonable cause.

* * * * *

[(3) REDUCED PENALTY FOR RETURNS RELATING TO FOREIGN PERSONAL HOLDING COMPANIES.—In the case of a return required under section 6035, paragraph (1) shall be applied by substituting “\$1,000” for “\$10,000”, and paragraph (2) shall not apply.]

* * * * *

SEC. 6700. PROMOTING ABUSIVE TAX SHELTERS, ETC.

(a) IMPOSITION OF PENALTY.—Any person who—

(1) * * *

* * * * *

Notwithstanding the first sentence, if an activity with respect to which a penalty imposed under this subsection involves a statement described in paragraph (2)(A), the amount of the penalty shall be equal to 50 percent of the gross income derived (or to be derived) from such activity by the person on which the penalty is imposed.

* * * * *

[SEC. 6707. FAILURE TO FURNISH INFORMATION REGARDING TAX SHELTERS.

[(a) FAILURE TO REGISTER TAX SHELTER.—

[(1) IMPOSITION OF PENALTY.—If a person who is required to register a tax shelter under section 6111(a)—

[(A) fails to register such tax shelter on or before the date described in section 6111(a)(1), or

[(B) files false or incomplete information with the Secretary with respect to such registration, such person shall pay a penalty with respect to such registration in the amount determined under paragraph (2). No penalty shall be imposed under the preceding sentence with respect to any failure which is due to reasonable cause.

[(2) AMOUNT OF PENALTY.—Except as provided in paragraph (3), the penalty imposed under paragraph (1) with respect to any tax shelter shall be an amount equal to the greater of—

[(A) 1 percent of the aggregate amount invested in such tax shelter, or

[(B) \$500.

[(3) CONFIDENTIAL ARRANGEMENTS.—

[(A) IN GENERAL.—In the case of a tax shelter (as defined in section 6111(d)), the penalty imposed under paragraph (1) shall be an amount equal to the greater of—

[(i) 50 percent of the fees paid to all promoters of the tax shelter with respect to offerings made before the date such shelter is registered under section 6111, or

[(ii) \$10,000.

Clause (i) shall be applied by substituting “75 percent” for “50 percent” in the case of an intentional failure or act described in paragraph (1).

[(B) SPECIAL RULE FOR PARTICIPANTS REQUIRED TO REGISTER SHELTER.—In the case of a person required to register such a tax shelter by reason of section 6111(d)(3)—

[(i) such person shall be required to pay the penalty under paragraph (1) only if such person actually participated in such shelter,

[(ii) the amount of such penalty shall be determined by taking into account under subparagraph (A)(i) only the fees paid by such person, and

[(iii) such penalty shall be in addition to the penalty imposed on any other person for failing to register such shelter.

[(b) FAILURE TO FURNISH TAX SHELTER IDENTIFICATION NUMBER.—

[(1) SELLERS, ETC.—Any person who fails to furnish the identification number of a tax shelter which such person is required to furnish under section 6111(b)(1) shall pay a penalty of \$100 for each such failure.

[(2) FAILURE TO INCLUDE NUMBER ON RETURN.—Any person who fails to include an identification number on a return on which such number is required to be included under section 6111(b)(2) shall pay a penalty of \$250 for each such failure, unless such failure is due to reasonable cause.]

SEC. 6707. FAILURE TO FURNISH INFORMATION REGARDING REPORTABLE TRANSACTIONS.

(a) *IN GENERAL.*—If a person who is required to file a return under section 6111(a) with respect to any reportable transaction—

(1) fails to file such return on or before the date prescribed therefor, or

(2) files false or incomplete information with the Secretary with respect to such transaction, such person shall pay a penalty with respect to such return in the amount determined under subsection (b).

(b) *AMOUNT OF PENALTY.*—

(1) *IN GENERAL.*—Except as provided in paragraph (2), the penalty imposed under subsection (a) with respect to any failure shall be \$50,000.

(2) *LISTED TRANSACTIONS.*—The penalty imposed under subsection (a) with respect to any listed transaction shall be an amount equal to the greater of—

(A) \$200,000, or

(B) 50 percent of the gross income derived by such person with respect to aid, assistance, or advice which is provided with respect to the listed transaction before the date the return is filed under section 6111.

Subparagraph (B) shall be applied by substituting “75 percent” for “50 percent” in the case of an intentional failure or act described in subsection (a).

(c) *RESCISSION AUTHORITY.*—The provisions of section 6707A(d) (relating to authority of Commissioner to rescind penalty) shall apply to any penalty imposed under this section.

(d) *REPORTABLE AND LISTED TRANSACTIONS.*—For purposes of this section, the terms “reportable transaction” and “listed transaction” have the respective meanings given to such terms by section 6707A(c).

SEC. 6707A. PENALTY FOR FAILURE TO INCLUDE REPORTABLE TRANSACTION INFORMATION WITH RETURN.

(a) *IMPOSITION OF PENALTY.*—Any person who fails to include on any return or statement any information with respect to a reportable transaction which is required under section 6011 to be included with such return or statement shall pay a penalty in the amount determined under subsection (b).

(b) *AMOUNT OF PENALTY.*—

(1) *IN GENERAL.*—Except as provided in paragraph (2), the amount of the penalty under subsection (a) shall be—

(A) \$10,000 in the case of a natural person, and

(B) \$50,000 in any other case.

(2) *LISTED TRANSACTION.*—The amount of the penalty under subsection (a) with respect to a listed transaction shall be—

(A) \$100,000 in the case of a natural person, and

(B) \$200,000 in any other case.

(c) *DEFINITIONS.*—For purposes of this section—

(1) *REPORTABLE TRANSACTION.*—The term “reportable transaction” means any transaction with respect to which information is required to be included with a return or statement because, as determined under regulations prescribed under section 6011, such transaction is of a type which the Secretary determines as having a potential for tax avoidance or evasion.

(2) *LISTED TRANSACTION.*—The term “listed transaction” means a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of section 6011.

(d) *AUTHORITY TO RESCIND PENALTY.*—

(1) *IN GENERAL.*—The Commissioner of Internal Revenue may rescind all or any portion of any penalty imposed by this section with respect to any violation if—

(A) the violation is with respect to a reportable transaction other than a listed transaction, and

(B) rescinding the penalty would promote compliance with the requirements of this title and effective tax administration.

(2) *NO JUDICIAL APPEAL.*—Notwithstanding any other provision of law, any determination under this subsection may not be reviewed in any judicial proceeding.

(3) *RECORDS.*—If a penalty is rescinded under paragraph (1), the Commissioner shall place in the file in the Office of the Commissioner the opinion of the Commissioner or the head of the Office of Tax Shelter Analysis with respect to the determination, including—

- (A) a statement of the facts and circumstances relating to the violation,
- (B) the reasons for the rescission, and
- (C) the amount of the penalty rescinded.

(e) *COORDINATION WITH OTHER PENALTIES.*—The penalty imposed by this section shall be in addition to any other penalty imposed by this title.

[SEC. 6708. FAILURE TO MAINTAIN LISTS OF INVESTORS IN POTENTIALLY ABUSIVE TAX SHELTERS.

[(a) IN GENERAL.—Any person who fails to meet any requirement imposed by section 6112 shall pay a penalty of \$50 for each person with respect to whom there is such a failure, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The maximum penalty imposed under this subsection for any calendar year shall not exceed \$100,000.]

SEC. 6708. FAILURE TO MAINTAIN LISTS OF ADVISEES WITH RESPECT TO REPORTABLE TRANSACTIONS.

(a) *IMPOSITION OF PENALTY.*—

(1) *IN GENERAL.*—If any person who is required to maintain a list under section 6112(a) fails to make such list available upon written request to the Secretary in accordance with section 6112(b) within 20 business days after the date of such request, such person shall pay a penalty of \$10,000 for each day of such failure after such 20th day.

(2) *REASONABLE CAUSE EXCEPTION.*—No penalty shall be imposed by paragraph (1) with respect to the failure on any day if such failure is due to reasonable cause.

* * * * *

**PART II—FAILURE TO COMPLY WITH CERTAIN
INFORMATION REPORTING REQUIREMENTS**

* * * * *

SEC. 6724. WAIVER; DEFINITIONS AND SPECIAL RULES.

(a) * * *

* * * * *

(d) *DEFINITIONS.*—For purposes of this part—

(1) *INFORMATION RETURN.*—The term “information return” means—

(A) * * *

(B) any return required by—

(i) section 6041A(a) or (b) (relating to returns of direct sellers),

(ii) section 6043A(a) (relating to returns relating to taxable mergers and acquisitions),

[(ii)] (iii) section 6045(a) or (d) (relating to returns of brokers),

[(iii)] (iv) section 6050H(a) (relating to mortgage interest received in trade or business from individuals),

[(iv)] (v) section 6050I(a) or (g)(1) (relating to cash received in trade or business, etc.),

[(v)] (vi) section 6050J(a) (relating to foreclosures and abandonments of security),

[(vi)] (vii) section 6050K(a) (relating to exchanges of certain partnership interests),

[(vii)] (viii) section 6050L(a) (relating to returns relating to certain dispositions of donated property),

[(viii)] (ix) section 6050P (relating to returns relating to the cancellation of indebtedness by certain financial entities),

[(ix)] (x) section 6050S (relating to returns relating to payments for qualified tuition and related expenses),

[(x)] (xi) section 6050S (relating to returns relating to payments for qualified tuition and related expenses),

[(xi)] (xii) section 6050T (relating to returns relating to credit for health insurance costs of eligible individuals),

[(xii)] (xiii) section 6052(a) (relating to reporting payment of wages in the form of term-life insurance),

[(xiii)] (xiv) section 6053(c)(1) (relating to reporting with respect to certain tips),

[(xiv)] (xv) subsection (b) or (e) of section 1060 (relating to reporting requirements of transferors and transferees in certain asset acquisitions),

[(xv)] (xvi) subparagraph (A) or (C) of subsection (c)(4) of section 4093 (relating to information reporting with respect to tax on diesel and aviation fuels),

[(xvi)] (xvii) section 4101(d) (relating to information reporting with respect to fuels taxes),

[(xvii)] (xviii) subparagraph (C) of section 338(h)(10) (relating to information required to be furnished to the Secretary in case of elective recognition of gain or loss), or

[(xviii)] (xix) section 264(f)(5)(A)(iv) (relating to reporting with respect to certain life insurance and annuity contracts), and

(2) PAYEE STATEMENT.—The term “payee statement” means any statement required to be furnished under—

(A) * * *

* * * * *

(F) subsections (b) and (d) of section 6043A (relating to returns relating to taxable mergers and acquisitions).

[(F)] (G) section 6044(e) (relating to returns regarding payments of patronage dividends),

[(G)] (H) section 6045(b) or (d) (relating to returns of brokers),

[(H)] (I) section 6049(c) (relating to returns regarding payments of interest),

[(I)] (J) section 6050A(b) (relating to reporting requirements of certain fishing boat operators),

[(J)] (K) section 6050H(d) (relating to returns relating to mortgage interest received in trade or business from individuals),

[(K)] (L) section 6050I(e) or paragraph (4) or (5) of section 6050I(g) (relating to cash received in trade or business, etc.),

[(L)] (M) section 6050J(e) (relating to returns relating to foreclosures and abandonments of security),

[(M)] (N) section 6050K(b) (relating to returns relating to exchanges of certain partnership interests),

[(N)] (O) section 6050L(c) (relating to returns relating to certain dispositions of donated property),

[(O)] (P) section 6050N(b) (relating to returns regarding payments of royalties),

[(P)] (Q) section 6050P(d) (relating to returns relating to the cancellation of indebtedness by certain financial entities),

[(Q)] (R) section 6050Q(b) (relating to certain long-term care benefits),

[(R)] (S) section 6050R(c) (relating to returns relating to certain purchases of fish),

[(S)] (T) section 6051 (relating to receipts for employees),

[(T)] (U) section 6052(b) (relating to returns regarding payment of wages in the form of group-term life insurance),

[(U)] (V) section 6053(b) or (c) (relating to reports of tips),

[(V)] (W) section 6048(b)(1)(B) (relating to foreign trust reporting requirements),

[(W)] (X) section 4093(c)(4)(B) (relating to certain purchasers of diesel and aviation fuels),

[(X)] (Y) section 408(i) (relating to reports with respect to individual retirement plans) to any person other than the Secretary with respect to the amount of payments made to such person,

[(Y)] (Z) section 6047(d) (relating to reports by plan administrators) to any person other than the Secretary with respect to the amount of payments made to such person,

[(Z)] (AA) section 6050S(d) (relating to returns relating to qualified tuition and related expenses),

[(AA)] (BB) section 264(f)(5)(A)(iv) (relating to reporting with respect to certain life insurance and annuity contracts), or

[(BB)] (CC) section 6050T (relating to returns relating to credit for health insurance costs of eligible individuals).

* * * * *

CHAPTER 76—JUDICIAL PROCEEDINGS

* * * * *

Subchapter A—Civil Actions by the United States

Sec. 7401. Authorization.

* * * * *

[Sec. 7408. Action to enjoin promoters of abusive tax shelters, etc.]
*Sec. 7408. Actions to enjoin specified conduct related to tax shelters
and reportable transactions.*

* * * * *

[SEC. 7408. ACTION TO ENJOIN PROMOTERS OF ABUSIVE TAX SHELTERS, ETC.]

[(a) **AUTHORITY TO SEEK INJUNCTION.**—A civil action in the name of the United States to enjoin any person from further engaging in conduct subject to penalty under section 6700 (relating to penalty for promoting abusive tax shelters, etc.) or section 6701 (relating to penalties for aiding and abetting understatement of tax liability) may be commenced at the request of the Secretary. Any action under this section shall be brought in the district court of the United States for the district in which such person resides, has his principal place of business, or has engaged in conduct subject to penalty under section 6700 or section 6701. The court may exercise its jurisdiction over such action (as provided in section 7402(a)) separate and apart from any other action brought by the United States against such person.

[(b) **ADJUDICATION AND DECREE.**—In any action under subsection (a), if the court finds—

[(1) that the person has engaged in any conduct subject to penalty under section 6700 (relating to penalty for promoting abusive tax shelters, etc.) or section 6701 (relating to penalties for aiding and abetting understatement of tax liability), and

[(2) that injunctive relief is appropriate to prevent recurrence of such conduct, the court may enjoin such person from engaging in such conduct or in any other activity subject to penalty under section 6700 or section 6701.]

SEC. 7408. ACTIONS TO ENJOIN SPECIFIED CONDUCT RELATED TO TAX SHELTERS AND REPORTABLE TRANSACTIONS.

(a) **AUTHORITY TO SEEK INJUNCTION.**—A civil action in the name of the United States to enjoin any person from further engaging in specified conduct may be commenced at the request of the Secretary. Any action under this section shall be brought in the district court of the United States for the district in which such person resides, has his principal place of business, or has engaged in specified conduct. The court may exercise its jurisdiction over such action (as provided in section 7402(a)) separate and apart from any other action brought by the United States against such person.

(b) **ADJUDICATION AND DECREE.**—In any action under subsection (a), if the court finds—

(1) that the person has engaged in any specified conduct, and

(2) that injunctive relief is appropriate to prevent recurrence of such conduct, the court may enjoin such person from engaging in such conduct or in any other activity subject to penalty under this title.

(c) *SPECIFIED CONDUCT.*—For purposes of this section, the term “specified conduct” means any action, or failure to take action, subject to penalty under section 6700, 6701, 6707, or 6708.

[(c)] (d) *CITIZENS AND RESIDENTS OUTSIDE THE UNITED STATES.*—If any citizen or resident of the United States does not reside in, and does not have his principal place of business in, any United States judicial district, such citizen or resident shall be treated for purposes of this section as residing in the District of Columbia.

* * * * *

CHAPTER 77—MISCELLANEOUS PROVISIONS

* * * * *

SEC. 7525. CONFIDENTIALITY PRIVILEGES RELATING TO TAXPAYER COMMUNICATIONS.

(a) * * *

[(b) SECTION NOT TO APPLY TO COMMUNICATIONS REGARDING CORPORATE TAX SHELTERS.—The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in section 6662(d)(2)(C)(iii)).]

(b) *SECTION NOT TO APPLY TO COMMUNICATIONS REGARDING TAX SHELTERS.*—The privilege under subsection (a) shall not apply to any written communication which is—

(1) *between a federally authorized tax practitioner and—*

(A) *any person,*

(B) *any director, officer, employee, agent, or representative of the person, or*

(C) *any other person holding a capital or profits interest in the person, and*

(2) *in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in section 6662(d)(2)(C)(ii)).*

* * * * *

SEC. 7528. INTERNAL REVENUE SERVICE USER FEES.

(a) * * *

* * * * *

(c) *TERMINATION.*—No fee shall be imposed under this section with respect to requests made after [December 31, 2004] *September 30, 2013.*

* * * * *

CHAPTER 79—DEFINITIONS

* * * * *

SEC. 7701. DEFINITIONS.

(a) WHEN USED IN THIS TITLE, WHERE NOT OTHERWISE DISTINCTLY EXPRESSED OR MANIFESTLY INCOMPATIBLE WITH THE INTENT THEREOF.—

(1) * * *

* * * * *

(19) DOMESTIC BUILDING AND LOAN ASSOCIATION.—The term “domestic building and loan association” means a domestic building and loan association, a domestic savings and loan association, and a Federal savings and loan association—

(A) * * *

* * * * *

(C) at least 60 percent of the amount of the total assets of which (at the close of the taxable year) consists of—

(i) * * *

* * * * *

(ix) loans made for the payment of expenses of college or university education or vocational training, in accordance with such regulations as may be prescribed by the Secretary, *and*

(x) property used by the association in the conduct of the business described in subparagraph (B) **[, and]**.

[(xi)] any regular or residual interest in a REMIC, and any regular interest in a FASIT, but only in the proportion which the assets of such REMIC or FASIT consist of property described in any of the preceding clauses of this subparagraph; except that if 95 percent or more of the assets of such REMIC or FASIT are assets described in clauses (i) through (x), the entire interest in the REMIC or FASIT shall qualify.]

* * * * *

(n) *SPECIAL RULES FOR DETERMINING WHEN AN INDIVIDUAL IS NO LONGER A UNITED STATES CITIZEN OR LONG-TERM RESIDENT.—An individual who would (but for this subsection) cease to be treated as a citizen or resident of the United States shall continue to be treated as a citizen or resident of the United States, as the case may be, until such individual—*

(1) gives notice of an expatriating act or termination of residency (with the requisite intent to relinquish citizenship or terminate residency) to the Secretary of State or the Secretary of Homeland Security, and

(2) provides a statement in accordance with section 6039G.

[(n)] (o) CROSS REFERENCES.—

(1) * * *

* * * * *

SEC. 7704. CERTAIN PUBLICLY TRADED PARTNERSHIPS TREATED AS CORPORATIONS.

(a) * * *

* * * * *

(d) QUALIFYING INCOME.—For purposes of this section—

(1) * * *

* * * * *

(4) CERTAIN INCOME QUALIFYING UNDER REGULATED INVESTMENT COMPANY OR REAL ESTATE TRUST PROVISIONS.—The term “qualifying income” also includes any income which would qualify under section [851(b)(2)] 851(b)(2)(A) or 856(c)(2).

* * * * *

CHAPTER 80—GENERAL RULES

* * * * *

Subchapter C—Provisions Affecting More Than One Subtitle

Sec. 7871. Indian tribal governments treated as States for certain purposes.

* * * * *

Sec. 7874. Rules relating to expatriated entities and their foreign parents.

* * * * *

SEC. 7874. RULES RELATING TO EXPATRIATED ENTITIES AND THEIR FOREIGN PARENTS.

(a) TAX ON INVERSION GAIN OF EXPATRIATED ENTITIES.—

(1) IN GENERAL.—*The taxable income of an expatriated entity for any taxable year which includes any portion of the applicable period shall in no event be less than the inversion gain of the entity for the taxable year.*

(2) EXPATRIATED ENTITY.—*For purposes of this subsection—*

(A) IN GENERAL.—*The term “expatriated entity” means—*

(i) the domestic corporation or partnership referred to in subparagraph (B)(i) with respect to which a foreign corporation is a surrogate foreign corporation, and

(ii) any United States person who is related (within the meaning of section 267(b) or 707(b)(1)) to a domestic corporation or partnership described in clause (i).

(B) SURROGATE FOREIGN CORPORATION.—*A foreign corporation shall be treated as a surrogate foreign corporation if, pursuant to a plan (or a series of related transactions)—*

(i) the entity completes after March 4, 2003, the direct or indirect acquisition of substantially all of the properties held directly or indirectly by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership,

(ii) after the acquisition at least 60 percent of the stock (by vote or value) of the entity is held—

(I) in the case of an acquisition with respect to a domestic corporation, by former shareholders of the domestic corporation by reason of holding stock in the domestic corporation, or

(II) in the case of an acquisition with respect to a domestic partnership, by former partners of the domestic partnership by reason of holding a capital or profits interest in the domestic partnership, and

(iii) after the acquisition the expanded affiliated group which includes the entity does not have substantial business activities in the foreign country in which, or under the law of which, the entity is created or organized, when compared to the total business activities of such expanded affiliated group.

An entity otherwise described in clause (i) with respect to any domestic corporation or partnership trade or business shall be treated as not so described if, on or before March 4, 2003, such entity acquired directly or indirectly more than half of the properties held directly or indirectly by such corporation or more than half of the properties constituting such partnership trade or business, as the case may be.

(b) *DEFINITIONS AND SPECIAL RULES.*—

(1) *EXPANDED AFFILIATED GROUP.*—The term “expanded affiliated group” means an affiliated group as defined in section 1504(a) but without regard to section 1504(b)(3), except that section 1504(a) shall be applied by substituting “more than 50 percent” for “at least 80 percent” each place it appears.

(2) *CERTAIN STOCK DISREGARDED.*—There shall not be taken into account in determining ownership under subsection (a)(2)(B)(ii)—

(A) stock held by members of the expanded affiliated group which includes the foreign corporation, or

(B) stock of such foreign corporation which is sold in a public offering related to the acquisition described in subsection (a)(2)(B)(i).

(3) *PLAN DEEMED IN CERTAIN CASES.*—If a foreign corporation acquires directly or indirectly substantially all of the properties of a domestic corporation or partnership during the 4-year period beginning on the date which is 2 years before the ownership requirements of subsection (a)(2)(B)(ii) are met, such actions shall be treated as pursuant to a plan.

(4) *CERTAIN TRANSFERS DISREGARDED.*—The transfer of properties or liabilities (including by contribution or distribution) shall be disregarded if such transfers are part of a plan a principal purpose of which is to avoid the purposes of this section.

(5) *SPECIAL RULE FOR RELATED PARTNERSHIPS.*—For purposes of applying subsection (a)(2)(B)(ii) to the acquisition of a trade or business of a domestic partnership, except as provided in regulations, all partnerships which are under common control (within the meaning of section 482) shall be treated as 1 partnership.

(6) *REGULATIONS.*—The Secretary shall prescribe such regulations as may be appropriate to determine whether a corporation is a surrogate foreign corporation, including regulations—

- (A) to treat warrants, options, contracts to acquire stock, convertible debt interests, and other similar interests as stock, and
- (B) to treat stock as not stock.
- (c) *OTHER DEFINITIONS.*—For purposes of this section—
 - (1) *APPLICABLE PERIOD.*—The term “applicable period” means the period—
 - (A) beginning on the first date properties are acquired as part of the acquisition described in subsection (a)(2)(B)(i), and
 - (B) ending on the date which is 10 years after the last date properties are acquired as part of such acquisition.
 - (2) *INVERSION GAIN.*—The term “inversion gain” means the income or gain recognized by reason of the transfer during the applicable period of stock or other properties by an expatriated entity, and any income received or accrued during the applicable period by reason of a license of any property by an expatriated entity—
 - (A) as part of the acquisition described in subsection (a)(2)(B)(i), or
 - (B) after such acquisition if the transfer or license is to a foreign related person.

Subparagraph (B) shall not apply to property described in section 1221(a)(1) in the hands of the expatriated entity.
 - (3) *FOREIGN RELATED PERSON.*—The term “foreign related person” means, with respect to any expatriated entity, a foreign person which—
 - (A) is related (within the meaning of section 267(b) or 707(b)(1)) to such entity, or
 - (B) is under the same common control (within the meaning of section 482) as such entity.
- (d) *SPECIAL RULES.*—
 - (1) *CREDITS NOT ALLOWED AGAINST TAX ON INVERSION GAIN.*—Credits (other than the credit allowed by section 901) shall be allowed against the tax imposed by this chapter on an expatriated entity for any taxable year described in subsection (a) only to the extent such tax exceeds the product of—
 - (A) the amount of the inversion gain for the taxable year, and
 - (B) the highest rate of tax specified in section 11(b)(1).

For purposes of determining the credit allowed by section 901, inversion gain shall be treated as from sources within the United States.
 - (2) *SPECIAL RULES FOR PARTNERSHIPS.*—In the case of an expatriated entity which is a partnership—
 - (A) subsection (a)(1) shall apply at the partner rather than the partnership level,
 - (B) the inversion gain of any partner for any taxable year shall be equal to the sum of—
 - (i) the partner’s distributive share of inversion gain of the partnership for such taxable year, plus
 - (ii) gain recognized for the taxable year by the partner by reason of the transfer during the applicable period of any partnership interest of the partner in

such partnership to the surrogate foreign corporation, and

(C) the highest rate of tax specified in the rate schedule applicable to the partner under this chapter shall be substituted for the rate of tax referred to in paragraph (1).

(3) COORDINATION WITH SECTION 172 AND MINIMUM TAX.—Rules similar to the rules of paragraphs (3) and (4) of section 860E(a) shall apply for purposes of subsection (a).

(4) STATUTE OF LIMITATIONS.—

(A) IN GENERAL.—The statutory period for the assessment of any deficiency attributable to the inversion gain of any taxpayer for any pre-inversion year shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may prescribe) of the acquisition described in subsection (a)(2)(B)(i) to which such gain relates and such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

(B) PRE-INVERSION YEAR.—For purposes of subparagraph (A), the term “pre-inversion year” means any taxable year if—

(i) any portion of the applicable period is included in such taxable year, and

(ii) such year ends before the taxable year in which the acquisition described in subsection (a)(2)(B)(i) is completed.

(e) SPECIAL RULE FOR TREATIES.—Nothing in section 894 or 7852(d) or in any other provision of law shall be construed as permitting an exemption, by reason of any treaty obligation of the United States heretofore or hereafter entered into, from the provisions of this section.

(f) REGULATIONS.—The Secretary shall provide such regulations as are necessary to carry out this section, including regulations providing for such adjustments to the application of this section as are necessary to prevent the avoidance of the purposes of this section, including the avoidance of such purposes through—

(1) the use of related persons, pass-through or other noncorporate entities, or other intermediaries, or

(2) transactions designed to have persons cease to be (or not become) members of expanded affiliated groups or related persons.

* * * * *

SECTION 209 OF THE SOCIAL SECURITY ACT

DEFINITION OF WAGES

SEC. 209. (a) For the purposes of this title, the term “wages” means remuneration paid prior to 1951 which was wages for the purposes of this title under the law applicable to the payment of such remuneration, and remuneration paid after 1950 for employment, including the cash value of all remuneration (including bene-

fits) paid in any medium other than cash; except that, in the case of remuneration paid after 1950, such term shall not include—

(1)(A) * * *

* * * * *

(17) Any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 117, or 132 of the Internal Revenue Code of 1986; **[or]**

(18) Remuneration consisting of income excluded from taxation under section 7873 of the Internal Revenue Code of 1986 (relating to income derived by Indians from exercise of fishing rights)**[.];** or

(19) *Remuneration on account of—*

(A) a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option (as defined in section 422(b) of the Internal Revenue Code of 1986) or under an employee stock purchase plan (as defined in section 423(b) of such Code), or

(B) any disposition by the individual of such stock.

* * * * *

TITLE 31, UNITED STATES CODE

* * * * *

CHAPTER 3—DEPARTMENT OF THE TREASURY

* * * * *

SUBCHAPTER II—ADMINISTRATIVE

* * * * *

§ 330. Practice before the Department

(a) * * *

* * * * *

(b) After notice and opportunity for a proceeding, the Secretary may suspend or disbar from practice before the Department, or censure, a representative who—

(1) * * *

* * * * *

The Secretary may impose a monetary penalty on any representative described in the preceding sentence. If the representative was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to such penalty, the Secretary may impose a monetary penalty on such employer, firm, or entity if it knew, or reasonably should have known, of such conduct. Such penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty. Any such penalty imposed on an

individual may be in addition to, or in lieu of, any suspension, disbarment, or censure of such individual.

* * * * *

(d) Nothing in this section or in any other provision of law shall be construed to limit the authority of the Secretary of the Treasury to impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which the Secretary determines as having a potential for tax avoidance or evasion.

* * * * *

CHAPTER 53—MONETARY TRANSACTIONS

SUBCHAPTER II—RECORDS AND REPORTS ON MONETARY INSTRUMENTS TRANSACTIONS

§ 5321. Civil penalties

(a)(1) * * *

* * * * *

[(5) FOREIGN FINANCIAL AGENCY TRANSACTION VIOLATION.—

[(A) PENALTY AUTHORIZED.—The Secretary of the Treasury may impose a civil money penalty on any person who willfully violates or any person willfully causing any violation of any provision of section 5314.

[(B) MAXIMUM AMOUNT LIMITATION.—The amount of any civil money penalty imposed under subparagraph (A) shall not exceed—

[(i) in the case of violation of such section involving a transaction, the greater of—

[(I) the amount (not to exceed \$100,000) of the transaction; or

[(II) \$25,000; and

[(ii) in the case of violation of such section involving a failure to report the existence of an account or any identifying information required to be provided with respect to such account, the greater of—

[(I) an amount (not to exceed \$100,000) equal to the balance in the account at the time of the violation; or

[(II) \$25,000.]

(5) FOREIGN FINANCIAL AGENCY TRANSACTION VIOLATION.—

(A) PENALTY AUTHORIZED.—*The Secretary of the Treasury may impose a civil money penalty on any person who violates, or causes any violation of, any provision of section 5314.*

(B) AMOUNT OF PENALTY.—

(i) IN GENERAL.—*Except as provided in subparagraph (C), the amount of any civil penalty imposed under subparagraph (A) shall not exceed \$5,000.*

(ii) *REASONABLE CAUSE EXCEPTION.*—No penalty shall be imposed under subparagraph (A) with respect to any violation if—

(I) such violation was due to reasonable cause, and

(II) the amount of the transaction or the balance in the account at the time of the transaction was properly reported.

(C) *WILLFUL VIOLATIONS.*—In the case of any person willfully violating, or willfully causing any violation of, any provision of section 5314—

(i) the maximum penalty under subparagraph

(B)(i) shall be increased to the greater of—

(I) \$25,000, or

(II) the amount (not exceeding \$100,000) determined under subparagraph (D), and

(ii) subparagraph (B)(ii) shall not apply.

(D) *AMOUNT.*—The amount determined under this subparagraph is—

(i) in the case of a violation involving a transaction, the amount of the transaction, or

(ii) in the case of a violation involving a failure to report the existence of an account or any identifying information required to be provided with respect to an account, the balance in the account at the time of the violation.

* * * * *

SECTION 13031 OF THE CONSOLIDATED OMNIBUS BUDGET RECONCILIATION ACT OF 1985

SEC. 13031. FEES FOR CERTAIN CUSTOMS SERVICES.

(a) *SCHEDULE OF FEES.*—In addition to any other fee authorized by law, the Secretary of the Treasury shall charge and collect the following fees for the provision of customs services in connection with the following:

(1) * * *

* * * * *

(5)(A) * * *

(B) For the arrival of each passenger aboard a commercial vessel from a place referred to in subsection (b)(1)(A)(i) of this section, **[\$1.75]** \$1.75.

(b) *LIMITATIONS ON FEES.*—(1)(A) Except as provided in subsection (a)(5)(B) of this section, no fee may be charged under subsection (a) of this section for customs services provided in connection with—

(i) * * *

* * * * *

(iii) the arrival of a ferry, except for a ferry whose operations begin on or after August 1, 1999, and that operates

south of 27 degrees latitude and east of 89 degrees longitude;
or

* * * * *

(7) No fee may be charged under ~~paragraphs~~ *paragraph* (2),
(3), or (4) of subsection (a) for the arrival of any—

(A) * * *

* * * * *

(9)(A) * * *

* * * * *

(B)(i) Beginning in fiscal year 2004, the Secretary of the Treasury may adjust (not more than once per fiscal year) the amount described in subparagraph (A)(ii) to an amount that is not less than \$.35 and not more than \$1.00 per individual airway bill or bill of lading. The Secretary shall provide notice in the Federal Register of a proposed adjustment under the preceding sentence and the reasons therefor and shall allow for public comment on the proposed adjustment.

(ii) Notwithstanding section 451 of the Tariff Act of 1930, the payment required by subparagraph (A)(ii) shall be the only payment required for reimbursement of the Customs Service in connection with the processing of an individual airway bill or bill of lading in accordance with such subparagraph and for providing services at express consignment carrier facilities or centralized hub facilities, except that the Customs Service may require such facilities to cover expenses of the Customs Service for adequate office space, equipment, furnishings, supplies, and security.

(iii)(I) The payment required by subparagraph (A)(ii) and clause (ii) of this subparagraph shall be paid on a quarterly basis by the carrier using the facility to the Customs Service in accordance with regulations prescribed by the Secretary of the Treasury.

(II) 50 percent of the amount of payments received under subparagraph (A)(ii) and clause (ii) of this subparagraph shall, in accordance with section 524 of the Tariff Act of 1930, be deposited in the Customs User Fee Account and shall be used to directly reimburse each appropriation for the amount paid out of that appropriation for the costs incurred in providing services to express consignment carrier facilities or centralized hub facilities. Amounts deposited in accordance with the preceding sentence shall be available until expended for the provision of customs services to express consignment carrier facilities or centralized hub facilities.

(III) Notwithstanding section 524 of the Tariff Act of 1930, the remaining 50 percent of the amount of payments received under subparagraph (A)(ii) and clause (ii) of this subparagraph shall be paid to the Secretary of the Treasury, which is in lieu of the payment of fees under subsection (a)(10) of this section.

* * * * *

(e) PROVISION OF CUSTOMS SERVICES.—

(1) * * *

(2)(A) * * *

(B) Subparagraph (C) of paragraph (6) shall not apply with respect to any foreign trade zone or subzone that is located at, or in

the vicinity of, an airport to which section 236 of the Trade and Tariff Act of 1984 applies.

* * * * *

(f) DISPOSITION OF FEES.—(1) There is established in the general fund of the Treasury a separate account which shall be known as the “Customs User Fee Account”. Notwithstanding section 524 of the Tariff Act of 1930 (19 U.S.C. 1524), there shall be deposited as offsetting receipts into the Customs User Fee Account all fees collected under subsection (a) except—

(A) * * *

(B) amounts deposited into the Customs Commercial and Homeland Security Automation Account under paragraph (5).

(2) Except as otherwise provided in this subsection, all funds in the Customs User Fee Account shall be available, to the extent provided for in appropriations Acts, to pay the costs (other than costs for which direct reimbursement under paragraph (3) is required) incurred by the United States Customs Service in conducting [commercial operations, including, but not limited to, all costs associated with commercial passenger, vessel, vehicle, aircraft, and cargo processing.] *customs revenue functions as defined in section 415 of the Homeland Security Act of 2002 (other than functions performed by the Office of International Affairs referred to in section 415(8) of that Act), and for automation (including the Automation Commercial Environment computer system), and for no other purpose. To the extent that funds in the Customs User Fee Account are insufficient to pay the costs of such customs revenue functions, customs duties in an amount equal to the amount of such insufficiency shall be available, to the extent provided for in appropriations Acts, to pay the costs of such customs revenue functions in the amount of such insufficiency, and shall be available for no other purpose. The provisions of the first and second sentences of this paragraph specifying the purposes for which amounts in the Customs User Fee Account may be made available shall not be superseded except by a provision of law which specifically modifies or supersedes such provisions.* So long as there is a surplus of funds in the Customs User Fee Account, the Secretary of the Treasury may not reduce personnel staffing levels for providing commercial clearance and preclearance services.

(3)(A) * * *

* * * * *

(E) *Nothing in this paragraph shall be construed to preclude the use of appropriated funds, from sources other than the fees collected under subsection (a), to pay the costs set forth in clauses (i), (ii), and (iii) of subparagraph (A).*

* * * * *

(j) EFFECTIVE DATES.—(1) * * *

* * * * *

[(3) Fees may not be charged under subsection (a) after March 1, 2005.]

(3)(A) *Fees may not be charged under paragraphs (9) and (10) of subsection (a) after September 30, 2013.*

(B)(i) Subject to clause (ii), Fees may not be charged under paragraphs (1) through (8) of subsection (a) after September 30, 2013.

(ii) In fiscal year 2006 and in each succeeding fiscal year for which fees under paragraphs (1) through (8) of subsection (a) are authorized—

(I) the Secretary of the Treasury shall charge fees under each such paragraph in amounts that are reasonably related to the costs of providing customs services in connection with the activity or item for which the fee is charged under such paragraph, except that in no case may the fee charged under any such paragraph exceed by more than 10 percent the amount otherwise prescribed by such paragraph;

(II) the amount of fees collected under such paragraphs may not exceed, in the aggregate, the amounts paid in that fiscal year for the costs described in subsection (f)(3)(A) incurred in providing customs services in connection with the activity or item for which the fees are charged under such paragraphs;

(III) a fee may not be collected under any such paragraph except to the extent such fee will be expended to pay the costs described in subsection (f)(3)(A) incurred in providing customs services in connection with the activity or item for which the fee is charged under such paragraph; and

(IV) any fee collected under any such paragraph shall be available for expenditure only to pay the costs described in subsection (f)(3)(A) incurred in providing customs services in connection with the activity or item for which the fee is charged under such paragraph.

* * * * *